S. Hrg. 103-288

HEARING ON ENTERPRISE ZONES

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BEFORE THE

COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE

ONE HUNDRED THIRD CONGRESS

FIRST SESSION

ON

ENTERPRISE ZONES

FRIDAY, JUNE 18, 1993

Printed for the Committee on Small Business

U.S. GOVERNMENT PRINTING OFFICE

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HEARING ON ENTERPRISE ZONES

FRIDAY, JUNE 18, 1993

U.S. Senate,
Subcommittee on Competitiveness, Capital
Formation, and Economic Opportunity,
Committee on Small Business,
Washington, DC.

The Subcommittee met, pursuant to notice, at 10:10 a.m. in room SR-428A, Russell Senate Office Building, Hon. Joseph I. Lieberman, Chairman of the Subcommittee, presiding.

OPENING STATEMENT OF HON. JOSEPH I. LIEBERMAN, A U.S. SENATOR FROM THE STATE OF CONNECTICUT

Senator Lieberman. Good morning, and welcome to this hearing of the Subcommittee on Competitiveness, Capital Formation, and Economic Opportunity.

The topic of our hearing this morning is enterprise zones. Two days ago, the Senate Finance Committee dropped the administration's Enterprise Community and Empowerment Zone plan from the President's budget package, marking yet one more setback in what is now a 12-year pursuit of enterprise zone legislation.

I intend to do all I can to assure that the budget package that emerges from the conference committee contains funding for enterprise zones. I am privileged to have been a long-time supporter of enterprise zones, though I must say not as long-time a supporter as our first witness, at least not here in the Congress. I think that the administration has actually put together a very thoughtful proposal, which represents a serious commitment to the program.

Unfortunately, as I have examined the administration's Enterprise Zone plan, I have become increasingly concerned with some of the details of the proposal. Specifically, I have questions regarding the number of empowerment zones, the cost of the zones, and the lack of capital incentives in the package. But, notwithstanding that, if there is any one point on which, I think, we all can agree, it is that desperate conditions exist in too many of America's inner cities: Crime, poverty, drugs, unemployment and homelessness. The old answers to those problems are not working, and we need some new answers, including enterprise and empowerment zones.

I think we know what some of the reasons for the problems facing America's poorest areas are; some of them have to do with the exodus of manufacturing, particularly from our cities. With the loss of that manufacturing went jobs, wholesale trade, retail businesses and a large source of local revenues.

At the same time, we saw a rise in poverty, crime, drug use, homelessness and illiteracy. So, with a shrinking tax base, cities needed to provide more services with less revenue. As a result, cities were forced to raise revenue from sources such as residential property taxes, which added to the outward migration of many homeowners. Finally, the infrastructure continued to decline and crime rates rose.

I am confident that enterprise zones offer us an opportunity to break this cycle, by directly countering one of those important causes of urban decline; and that is, namely, the reduction of business activity, investment and jobs.

We have now had more than 10 years of experience with enterprise zones, and we know they work. At the State level, 36 states have adopted enterprise zones since 1982. According to the States themselves, those zones have created more than a quarter of a million jobs, and have attracted more than $28 billion in capital investments. And that has all be done without Federal tax incentives, which are a real sweetener in this whole idea.

The State experience provides evidence that, if properly designed, enterprise zones will help convince businesses to build and grow in poor neighborhoods. That is why enterprise zones have been endorsed by a wide range of groups, including the national Governors' Association, the national Council of State Legislators, the Council of Black State Legislators, the Conference of Mayors, and the Conference of Black Mayors.

The proposal put forth by the administration contains some important steps in the right direction. It really represents a serious commitment of revenues. It provides a coordinated approach with existing Federal spending programs. It provides tax-exempt bond financing to all eligible areas. And it incorporates a number of the proposals in the Urban Community Building Act of 1993, introduced by Senator Bill Bradley, which I co-sponsored, including community policing and enterprise grants.

But, in my opinion, the bill falls short in two key areas: The number of zones; and the lack of capital-based investment incentives.

The proposal calls for only 10 urban and rural communities around the country to be designated as Enterprise Empowerment Zones. While the President's proposal does purport to create 100 enterprise communities, and 10 empowerment zones, the 100 cannot really be characterized as enterprise zones, and do not get a package of incentives that would make enterprise zones work. They would also leave out a lot of cities around our country that are desperately poor, and need this help but will not get it.

There is some suggestion that the program is designed with the limited number of zones in order to test the enterprise zone concept. But as I have said this morning, it seems to me that the record is clear: enterprise zones work.

They do not represent a radical departure from what States have been doing for a long time. States run by Democrats or Republicans, liberals or conservatives, have used tax incentives to attract businesses; and that is what enterprise zones are all about.

Finally, let me just briefly address the issue of incentives. In order for the program to achieve its desired results, the incentives

must be strong enough and practical enough to attract necessary business and investment activity. I think the package of incentives must reduce capital, as well as labor, costs. I cannot stress enough the importance of these capital incentives. They have got to be a component of any program, and should be targeted toward small business, because it is seed capital and cash flow that are two of the most common barriers to small business creation, particularly in the inner city, and particularly among minority men and women.

Let me say, finally, that it is time to do something substantial, but not just substantial; something, to do something fresh and new, on a national scale, about urban and rural decay, chronic unemployment in our inner cities and our rural areas. And I believe a properly constructed enterprise zone program is just the way to do that.

Senator Mack?

STATEMENT OF HON. CONNIE MACK, A U.S. SENATOR FROM THE STATE OF FLORIDA

Senator Mack. Thank you, Mr. Chairman. I first of all want to commend you for holding this hearing, and putting forth your ideas with respect to the package that came out of the Finance Committee, pointing out what I think is a significant deficiency. I also want to associate myself with the comments that you just made, and welcome my former colleague in the House, Representative Rangel. I am delighted that you are here this morning, and look forward to your testimony. I will just make a few brief remarks, and ask that my statement be included in the record.

Senator Lieberman. It will.

Senator Mack. I think most of the time, most of us make decisions either from a rational perspective, or emotional perspective.

From the rational side, it seems to me that we need to provide capital incentives, as well as labor incentives, in the hardcore unemployed areas of our country, if we really want to see that our urban centers can survive, and that we stop the drain from the urban centers. If we do not take that approach, it seems to me that we will be constantly asked to provide more and more subsidies each year to allow the urban centers to survive.

People who might not be driven from either an emotional or moral perspective about our responsibility to our fellow man, at least should be driven by the concept that we would be better off economically to make those kinds of decisions and prove those kinds of incentives, to help in the development of new businesses, and providing capital and opportunity for minorities in our urban centers.

But from an emotional perspective, I think there is sufficient reason to respond as well. Just one story: In one of my earlier trips throughout the State of Florida, after having been elected to the Senate as a member of the Banking Committee and on the Subcommittee on Housing, Eddie Taylor took me through a public housing community in Melbourne, FL. We went in and we looked at some of the apartments that had been basically destroyed. And these apartments were being used for anything that you can imagine.

As we came out of those really dilapidated environments, Eddie pointed to a young fellow who was maybe 4 or 5 years old walking down the sidewalk between these two buildings. And what Eddie said to me was that if we do not change the view, if we do not change the perspective that that little fellow looks out into the future, what possible hope can there be for him? A person cannot dream beyond what they can see. They have to have some sense that there is an opportunity.

So, as I said I think there are two factors that motivate us. In this particular case, I am motivated both by the emotional and the moral perspective, as well as the economic. So I look forward to your testimony, and again I commend Senator Lieberman for his leadership in giving us the opportunity to highlight the necessity of moving forward with respect to enterprise zones.

Senator LIEBERMAN. Thank you, Senator Mack, for that statement. And I just want to say that it is always a pleasure to work with you.

Congressman Rangel, we are delighted that you are here this morning. We thank you for taking the time to come over. You have been a true leader in this, and in so many other areas that matter to people, that it means a lot to us to hear your voice this morning. And we look forward to your testimony now. Thank you.

STATEMENT OF HON. CHARLES RANGEL, A U.S. REPRESENTATIVE FROM THE STATE OF NEW YORK

Mr. RANGEL. Thank you, Mr. Chairman. It is indeed a great honor to be extended the privilege to be the start-off witness to a hearing that is so important to our Nation. But it is even more of a pleasure to be here with two friends, that we can talk not only as legislators but as people who love our country and really want to do the best that we can as public servants to make certain that she remains strong and competitive, not just for ourselves but certainly to improve on the legacy that has been left to us.

Far more eloquent arguments for enterprise zones were made yesterday on the floor of the House of Representatives. Unfortunately, they were not talking about enterprise zones; they were talking about aid to Russia in the context of the Foreign Assistance Bill. And Republicans and Democrats, the leadership as well as the freshmen, came together and they said: This is a crisis that calls for immediate reaction. That, if we do not help our friends in the former Soviet Union, then we will have a credibility gap in terms of the standards of morality that we are setting for the world.

That we are talking about reducing the deficit, increasing trade, and increasing competition and productivity; and the people in the former Soviet Union, as they search for a Democratic agenda, are demilitarizing, their soldiers are coming home, some have lost their families, others have no homes, no comparable job training, no employment.

There is an increase in drinking and drug abuse, crime is increasing; they are among the top per capita of having people put in jail, which is so unproductive. Of course, the United States is at the top. Many argued that if we did not move in now, once the people became as frustrated as Senator Mack had indicated, once they be-

lieve that democracy does not work for them—that they knew they were eating under Communism—but if all of our promises of being there when you need us are shattered and broken, and we lose our credibility, then down the line we may have to pay more than the small investment that we were being asked to pay yesterday in the Foreign Assistance Bill.

Bosnia is a classic example as to the extremes that human beings will go, when they are not driven by a rational pursuit. So, do not let the former Soviet Union pick up arms; do not let them be frustrated. Help them to be productive, and to be able to become consumers of American goods.

Establish trade, and let trade and economic development through education and job training be our way to keep peace in the world—to be able to help each other. And not to frustrate people because of a class system, where those that have flaunt it, and those who do not have do not even believe that they are on the radar screen.

Well, I would have no argument with that; except that it seems to me that the best way to help other people would be based on our experience as to: What did we do with our own citizens who were similarly situated?

I shared in the anguish of soldiers returning home to conditions that were less than fair; it hurts me still today, to see friends of my late brother who came home from World War II, and that German prisoners of war, were treated better than the black and African-American GIs.

When I came home from Korea, most people did not even know where Korea was. They did not know why I was there. I have to admit, I had some doubts myself. But I came home with the Purple Heart and the Bronze Star; I did not have any job. I did not have any job training. Fortunately for me, I had the GI Bill, and an opportunity, not having a family, to take advantage of it. But how many of those people came home to a broken family condition?

As the economy worsened and the Vietnam War intensified, as minorities sought and volunteered as an economic solution to their problem as I did, by joining the military, we find that American fighting men came home to worse conditions than in Vietnam, because we not only disliked the war in Vietnam, but somehow we disliked the people who participated in the war, even though the President, the Commander-in-Chief, and the Congress directed them to do it.

In any event, I tried to think about Russia and tried to think about my district and the districts like it throughout these United States, where over half of the homeless are United States veterans; the increased percentage of veterans that are incarcerated for nonviolent crimes. I think veterans, just by themselves, deserve more. And I only concentrate on that because of yesterday's testimony on behalf of the Soviet Union, the people of the former Soviet Union people.

But, when I was chairman of the Narcotics Committee in the House, which of course was eliminated for fiscal reasons, I had an ongoing exchange and dispute with the administration, in trying to show them that while they constantly referred to the War Against Drugs, they really had no plan, no definite plan, to see what each part of Government, what each subcommittee, committee, what

each House, the Representatives or the Senate, can do in order to win a war. And I said, I have seen how strategies exist, and how the Congress is supposed to support these fights.

Dick Darman asked to meet with me, and asked me to share my views as to what America was losing by not dealing with this problem the same way we are asked today to deal with the problems in Eastern Europe. I wanted to share with him that if we were going to get rid of our deficit, it seems to me—I am not an economist—that we have to find out: Where is the hemorrhage? Where are we losing a lot of money? Where are we losing the potential to raise a lot of money? That is the only way to balance a budget, it seems to me. So, we have had several meetings in the White House, just accumulating data on our own and me asking him to research as to the national cost.

Because in my community, we have a serious crime problem. And politicians seem to be more prone to resolve this problem by increasing penalties and building more jails, rather than investing in the schools. When you check it out, we pay upward to $60,000 a year to keep a kid in jail. Seventy percent of them return to jail between 3 and 5 years after discharge. They now have become the incubator for the spread of AIDS, as well as a new strain of tuberculosis.

When you just wonder why the system is not working, it was Reverend Jesse Jackson who said that conditions are so bad on the streets of the inner cities, that the fear of going to jail that you and I know, that is a part of our memory bank, does not really exist for a kid. For me, it was such a nightmare that the thought of getting arrested would run chills up and down my spine.

As a matter of fact, when I became an Assistant U.S. Attorney, and they told me that my whole life had to be investigated by the FBI, because I did not know about the Statute of Limitations, I said, I do not think the job is really that important to me. It is just a fear that we were raised with: That your whole career, the opportunity, a Civil Service job, is gone.

If you have no job, no family, no hope for training, if you are illiterate, then when they talk about America needing to bounce back, and that we have to get people back to work, when you know they are not talking about you, then what does jail really mean? And that is what Senator Mack was talking about.

It means that you are taken off of the streets, and you have less danger of being mowed down by automatic weapons. It means that you will be provided what is so needed, and is absent in the community, adult supervision; the opportunity for a kid to talk to an adult, and to find out without humbling him or herself, what they know. Because they know they are stupid.

You get climate control, you get a well-balanced meal, you get health care, you get cable TV, you get movies, you get recreation. But the most important thing that you get is that you get some kind of prestige and respect by your peers. Because there is none for you at home or in the streets. So when you come out, you get a hashmark for time served.

Yet, we find that because of the different cultures that are pouring into our cities from all over the world, kids are finding it hard to assimilate. They do not know English. Some from the Caribbean

are people who do not understand what others are talking about. The school system, with many languages spoken that in it, is not working because the kids are dropping out. As the Chairman said, there are no avenues of opportunities in terms of employment at the low level, where lack of job skills are not an impediment to getting a job.

We have become, in the City of New York, not a manufacturing but a servicing center. Oh, they tell us that, you just wait until this treaty with Mexico goes through, we are going to have a greater job opportunity. But the question will remain: For whom? And we find that, once the kids get on the street, they see ways to make money. And most of the time, these ways are crime.

The drug addict is costing us, if he gets off of the street and gets into treatment at one of our hospitals, 600 bucks a day. When a kid is born out of a relationship with addicts, addicted to drugs, it costs $6,000 a day just to keep him or her alive. If there is permanent damage, if there is AIDS, then we are talking about millions of dollars invested in one kid; most of whom have been abandoned by their parents, just left there in the hospital. They become a charge to society.

We started adding up all of the costs that are necessary to support a kid that we did not cut off at the first juncture, by investing in the school system or recreational system, a job training system, and an opportunity for them to feel a part of the system, where they can pay taxes and tell anyone who wants to talk about riots to go to hell, because they say, this is my country, my city, my town, and my block, and it is just stupid for me to destroy it, especially the stores, because that is my job.

Dick Darman went to the computers, and it took months in order to get the information compiled. And when he threw in the health cost, the educational additional cost for these kids, the criminal justice cost, the social agency cost, the lost productivity, the lost competitiveness, and the lost revenue—which somehow, economists can do and you cannot challenge them—the figure came to $300 billion a year.

It frightened me, because I used to make up figures, saying $500 billion a year. And they would say, Oh my God, no. When they say $300 billion a year, I think I am right; and I did not know what I was talking about.

We have figures today from Secretary Shalala showing it is $38 billion just dealing with the health care. The addicts go to the inner city clinics with overdoses, or hurt as a result of violent crimes related to drugs, kidney disease, heart failure, and a variety of other illnesses that would not occur.

So, the question was then: What do you do about this? And I said, it's a war. The President said it was a war. President Reagan said it was a war. President Bush said it was a war. I know war. And I know that what you do is you go to a chart, and you find out the strength of the enemy that is hurting you the most.

I asked Dr. Darman, as an economist, if you are concerned about spending and capping entitlements, why do you not find out where that money is going? How productive is it? So he went and computed all of these things. And I asked him to find out what communities are consuming all of that. Find out where the highest crime

rates are; the highest drug addiction rates; the highest dropouts; the highest teenage pregnancy. Find out where you have the highest unemployment. And target these areas on some kind of a map.

I said, Mr. Darman, if when you have finished doing this, you find clusters in this community, then you do not have to start talking about entitlements. You have to talk as an economist: How can you cut your losses? How can you keep the people out of jail? We have over a million people incarcerated. It had cost us $20 billion a year, just to keep them in jail.

We have $20 billion allocated in Local, State and Federal Courts, to rebuild new prisons. Anyone that is in prison construction or criminal justice, they do not have to worry about the recession. It is a boom. It is going on now. More kids, minorities, are in these jails than we ever dream would have completed high school. And most of them are dumb kids. They are illiterate. But so was I. But given the opportunity, these kids want to be able to do something besides rot in jail indefinitely, or be exposed in the streets to death or violent injuries.

Mr. Darman said the President is prepared to support a program that does not start with entitlements and is not so broad that it just never ends and we have to find some way to test this, and so I said, boy, I have to start thinking Republican.

Senator LIEBERMAN. The timing is good. As you said that, if you look to your left——

[Laughter.]

Mr. RANGEL. I was going to mention his name later, because he was involved in this. I said, I have got to start thinking Republican, because these fellows over here, they are not dealing too much with compassion and morality and the right thing to do——

[Laughter.]

Mr. RANGEL [continuing]. They are dealing with the budget and you can keep them up all night if you talk budget talk, and so I started bringing in the figures, that we are losing $300 billion. And one of the ways I think we can do it is like Jack Kemp would say do it, even though between you and me I do not really think that this thing that Jack is talking about is going to work, because it is a whole lot of tax incentives.

It is a trickle-down thing, and people are supposed to get excited. You increase the capital and give them a break, and then they are going to rush into the drug-infested communities and say, hey, where are those drop-outs and ex-cons you were talking about? We are here to make money, you know.

[Laughter.]

Mr. RANGEL. But, I said, I think that an enhanced enterprise zone plan might work, and then I said, I know another great idea, and I stole it from the Republican, Thornburgh, weed and seed.

He had some idea that if you put 80 percent of the people in jail and seed with 20 percent, that this would deter other people from going to jail. I thought we should flip-flop it, but you know, I said weed and seed. They say that makes a lot of sense, and we turned it around, and we said, 80 percent seed.

So we started drafting this bill that was conceived by Jack Kemp supported mainly by Bobby Garcia, and because I love Jack Kemp and wanted to keep him as a friend I put my name on it because I

knew in the Ways & Means Committee nobody was pushing it, not Republicans, not Democrats, and he had over half of the House as co-sponsors. But no one was pushing the bill in either the Finance Committee here or in the Ways & Means Committee.

In the course of trying to work this thing out, something happened in Los Angeles. The lid blew, and all of a sudden President Bush knew that there was someone that was talking about this happening named Jack Kemp, and then Jack Kemp was all over TV explaining, hey, you have got to really deal with this problem, and this is not offensive because President Reagan really at one point did not even know who the Secretary of HUD was, at all.

At least, they knew who he was, but Jack Kemp started a plea that we have to get ahead of the curve, that we cannot wait for the Los Angeles' to happen, that we have to really start training these kids, get capital into these communities and let the American dream become a part of these communities, that nobody that can dream, that can think, that has a job, wants to end up in jail or in the morgue, and that the best way to do it is to target.

You do not target entitlements. You do not fight a war and just shoot everybody who is supposed to be the opposition. You break up the strength of the opposition, and the strength of misery and despair and lack of hope that is evident in your addiction rates, your crime rates, your unemployment rates, broken marriages, the unwanted children, AIDS, the drug crises, the alcohol problems. My God, they are having a honeymoon in Russia compared to the misery and fear that is going on in the inner cities, and indeed, now the suburban and rural areas of the United States.

So enterprise zones got new attention. It was so important after Los Angeles that they did not even want to go through the legislative process. They called Jack Kemp in and he called in the leadership and said, oh, he was a big shot, everyone is a big shot, and we got a bill.

Now, that bill passed twice, and I have to admit that it was a trailer to another bill that the President vetoed on both occasions, but the $500 million that we have for the social services to kick off, the first thing that happened was the Senate stole that money for the mini-stimulus package.

We have no authorization bill even today to deal with the enterprise zones. We have only done the tax part, which is $5.2 billion, $1 billion a year, but gentlemen, I would not con you, that $5.2 billion will never be used if we do not create a climate that is conducive for business people wanting to take the risk in these communities, because they know that the community, the families, the elected officials and the Governments want to become partners with them to make this system work.

So we put together a variety of things, and Jack Kemp became the leader in trying to make this become a reality, and yet he will tell you that this is as close as we ever got, and now the Senate seems to be saying, it is sending a message, well, the billions of dollars that we spent and sunk into Los Angeles we are prepared to take a gamble and say it is not going to happen again.

Please, for the sake of the budget, please save the Government money by realizing that the summer is not over. We flunked the test in summer jobs, and the most important thing that poor folks

need, the most important thing they need is hope, hope that maybe one day they can make it.

Once they decide that they are out of the loop, then you get what I get from many of my friends, and now because of my age, children of my friends whom I see on the street addicted, and they congratulate me for my efforts in fighting drug trafficking, and I said, how can you say that when you have given up on life? You are there.

They said, that is the reason I can say it. I want you to fight so that other people do not become addicted. For me, all I have is misery and pain. I am not wanted by my family, I am not wanted by my former friends, and I have a lot of pain, and Congressman, you cannot take away from me the little thing called drugs that eases that pain.

I have to walk away. I cannot deal with it, because they do not care whether they die, they just want to ease the pain.

So I am glad that you two are trying to get this back on the agenda. I do not know what it takes to influence your colleagues that we are talking about America. We are talking about competition, we are talking about productivity, and nobody can engage a million people who are doing nothing but lifting weights and watching TV, and say that we are going to compete against our other trading partners.

Certainly if we are not doing it in school, let us have a partnership with the private sector. Ask them what they want as the labor market of the future, and let us join with them, give the incentives to them, encourage them to form a new relationship with the inner cities where we can prosper.

If we can do it with developing countries, God knows, we can do it in our own, and I will do any and everything—come over here, stay away from here, talk with people you ask me to—but please at least get it back on the agenda, because in conference we are going to have a difficult time trying to make a bill compatible to both the House and Senate, and whether you are liberal or a conservative, Republican or Democrat, America has to move forward, and we only have one President at a time.

Thank you so much.

[The prepared statement of Congressman Rangel follows:]

Prepared Statement of Hon. Charles B. Rangel

I want to thank Senator Lieberman and the members of the Subcommittee on Competitiveness, Capital Formation and Economic Opportunity of the Committee on Small Business for inviting me to testify on enterprise zones. There is no question of Senator Lieberman's dedication to making a difference in the inner city and to promoting enterprise zones as an instrument for that change. I hope that this hearing will help him to advance the effort to recognize and to deal with the problems of the inner city.

This hearing is especially important given recent disappointing developments in the Senate affecting enterprise zones. Just yesterday, the Senate Finance Committee Democrats completely deleted the provisions from the House Reconciliation bill that would have created a $5 billion 5-year incentive program for Empowerment Zones as proposed by President Clinton. The other day the Appropriations Committee of the Senate rescinded the $500 million appropriation for Fiscal Year 1993 for enterprise zones. Fortunately, neither of these actions is yet final in either the Senate or the Congress. I am hopeful these actions can be reversed and we can move forward with the beginnings of a genuine urban package.

For too long we have neglected the ever growing despair of the inner cities. We have been debating for a decade about budget deficits, but we have failed to recognize where one of the major hemorrhages creating the deficit originates. It is in our inner cities and its is caused by the despair that creates the culture of crime and drugs.

Among many of the Nation's poorest and destitute communities there has been an acceleration of the disintegration of the social and economic fabric. These communities are not likely to recover with any economic upturn. They are not likely to be freed from a vicious spiral of depression, decay and desperation. In these communities crime is rampant jobs nonexistent, decent affordable housing scarce and the commerce and use of illegal substances the most significant element of the local economy.

The environment for the poverty, drugs, and crime in these communities has become the home of a marginal class of Americans living on the fringe of the economic and social main stream. These people no longer share in the American dream. Increasingly, they have no stake in the civic culture and the conventional values that bind our society. Their numbers and their sheer desperation threatens to unspool the basic tenets of our economic and social order, while posing a fundamental challenge to all of us who believe in the promise of America.

If we are to meet the challenges of the ever competitive world, we must address these communities.

As Chairman of the Select Committee on Narcotics Abuse and Control and a member of the Committee on Ways and Means, I have had a unique vantage point from which to explore the economics of drugs, crime and poverty. I was curious as to what these problems were costing us and to what degree they contributed to reducing our Nation's ability to compete and to our budget deficit.

The health care price tag for drug and alcohol abuse is tremendous. Over 30 percent of AIDS cases can be linked to IV drug use and it costs over $60,000 per year to care for one with AIDS. Low birthweight crack babies cost $5,500 per day for hospital care. Drug use is the major contributor to the growing use of expensive emergency rooms and most recently to the epidemic of treatment resistant tuberculosis. We cannot afford to add burdens to a health care system which is already strained.

Over the years, our Nation has invested tremendously in police, prosecutors, bailiffs, wardens, probation and parole and prisons, yet the crime rate continues to be sustained. We are second only to South Africa in the national rate of incarceration. There are over 750,000 Americans in prison and over 400,000 in local jails with about 70 percent having a history of drug use. To keep them in prison we spend nearly $20 billion per year. In New York, we spend $60,000 per year to incarcerate a prisoner at Riker's Island. How much are we doing for our long run productivity when we call for a greater investment in law enforcement to warehouse people one-third of whom when freed from prison return within 5 years?

Recently, Jesse Jackson described the dilemma for inner city youths illustrating why I believe we are missing an opportunity to tap a tremendous reserve of talent and productivity. Rev. Jackson notes why for so many inner city young men prison is a viable alternative, a badge of honor instead of a mark of shame. In prison these young men are out of the range of automatic gun fine, receive three balanced meals per day, exercise and have cable TV and movies, live in climate controlled quarters, get adult supervision, and have a sense of community.

Many of our problems with these young men can be traced back to their dropping out of high school. Some 30 percent of the male high school dropouts are either on probation, parole or in jail. Over a lifetime, each class of dropouts earns $237 billion less than its high school graduate counterparts. The result is a loss of $70 billion in tax revenues, increased government expenditures of $3 billion for unemployment and welfare and $3 billion more for increased crime prevention related to their dropping out.

Even the Bush Administration was willing to admit the enormous magnitude of what drugs and crime is costing the Nation. They pegged the cost in the neighborhood of *$300 billion per year*. It is a startling, mind boggling amount that we pour down a sinkhole every year.

How can we reduce the deficit, change the communities in trouble, and be competitive in the new economic order if this condition has become the reality in every major city?

I suggest that we can solve this problem without creating new programs or spending additional money, but acting as though we were at war and concentrating our efforts on where the enemy, in this case poverty and despair, is entrenched. As a society, we must ask this fundamental question: What is a better investment for our

government, spending $38,000 a year to keep a kid in jail, or $5,600 to keep that kid in school?

I want to go beyond tax breaks. No businessman is going to locate in an area with high crime, an uneducated and unemployable labor pool of drug addicts and ex-cons and inadequate health care and housing no matter how great the tax breaks.

If we are going to get business into these communities to create the opportunity to change them and make those we had forgotten productive contributors to the economy, we have to readjust how we were facing these problems.

There was willingness to rebuild our allies and our defeated foes after World War II. It was done for humanitarian reasons and to contain the Communist threat. But, it also resulted in creating economies that became our strong trading partners making all of nations economically stronger. We are now willing to spend billions in the former Soviet Union and other former Iron Curtain nations. We not only want them to be politically stable, but to be our trading partners. We hope in this manner they will not become dependent. If we can take this approach with Europe twice in 50 years, I cannot fathom why we cannot take the same approach with our cities.

First, we must admit that whatever we are doing is not working. In the decade just passed, our Nation doubled its prison population, created mandatory sentences for dozens of drug offenses, expanded capital punishment, greatly extended the powers of police and prosecutors—all while the crime rate doubled and the consumption of illegal drugs skyrocketed.

Second, fixing blame is not a highly productive exercise. For some reason there is a part of us that needs to hold someone responsible for things that have gone wrong. Frankly, it is one of the greatest obstacles to finding solutions. From my years of working on urban problems, I can assure you there is no single individual, or political leader, or institution on whose shoulders we can exclusively fix blame. Similarly, I don't think we gain anything by faulting the victims. The idea that we have to make moral judgments about who should be helped and who should be blamed sets us on a dangerously misguided course.

Third, the answers are complicated. Our national tendency to apply simple answers to complex problems, in this case, is both naive and dangerous. I applauded Mrs. Reagan's Just-Say-No campaign; but it was never a solution to the drug crisis. Babies born addicted to cocaine hardly had a chance to just say no; nor did the thousands of abandoned teenagers languishing in foster care. Try to explain to an abused wife how easy it is to just say no to an addict husband.

Fourth, the answers are not cheap. Rebuilding torn communities, healing broken lives, and restoring a sense of vitality and commitment to our future is not an inexpensive proposition. No amount of cheer leading or slogan-making is going to take the place of creative leadership, individual initiative, and substantial investment The 1980's have taught us that we are in a pay-now or pay-a-lot-more-later situation. It is important that we see money well-spent on programs today as funds well-invested in the America that will belong to our children. For example, we know that every dollar spent on Head Start today saves nearly $5 in future social costs. We know that graduates of Job Corps are more likely to hold steady jobs, make more money, and stay out of jail than their unskilled ¶5 counterparts. We know that $1 spent on immunizing poor children will save $10 in future medical costs. While the cost of action is high, the price of inaction is staggering.

Finally, we know the most effective initiatives to bring about social change in this country have been grounded in the community and the commitment of community leaders to pull together. In this present effort, we should not lose sight of this essential. Whatever strategy we ultimately choose must be premised on the idea of enabling local leaders and enhancing local initiative if it is to succeed at all.

My point is this: We do not need to create a single new program to help those communities which have been most devastated by the social and economic calamities of the past 12 years. Good programs are there. Strong community leaders are there. The commitment of the American people is there. The element that is missing is a coordinated, comprehensive strategy to invest in our communities in a way that empowers our people to attack these problems creatively and aggressively where they are occurring.

That strategy is now offered in the Empowerment Zone program of President Clinton.

Mr. Chairman, the idea of enterprise zones is not new. It is a concept which has been championed by leaders as diverse as you, Mr. Chairman, the Chairman of the House Committee on Ways and Means, former President Bush's Secretary of Housing and Urban Development Jack Kemp, and now President Bill Clinton.

We have had several hearings in the House on enterprise zones. What we have concluded is that there is a need to have a two pronged attack effective spending and focused tax incentives. We have also learned that if we are to improve economic activity inn the zones we need to encourage small. To do so we must have usable capital incentives and provisions to provide relief for cash flow needs. These are the two crucial obstacles for small businesses.

While the President's bill only provides for comprehensive assistance for 10 communities of which only 6 are urban areas, it does represent the vanguard for the kind of comprehensive effort necessary to turn the environment of despair around. This proposal combines the popular and, as yet, unfulfilled promise of enterprise zones with ideas of local initiative, social investment, and neighborhood leadership. It provides an opportunity to break free from the cycle of ubiquitous poverty, unemployment violence, and drug abuse, and start back on the long, long road to self sufficiency and prosperity. It does not rely on the direction of bureaucrats in Washington or even the state houses or city halls, but on the energies and wisdom of local leaders, their neighbors, and their institutions. The proposal provides these communities with the tools and commitments necessary to rebuild and renew.

The President is asking for a commitment of $500 million per year in new spending for his program. He is, in fact relying upon the $500 million from the Fiscal Year 1993 appropriation that I mentioned has been rescinded by the Senate Appropriations Committee. He is also seeking to as he says "reinvent government" by requiring those communities seeking to have a zone to provide a comprehensive plan for redevelopment of not only the physical plant of their community, but its entire fabric. I am sure that Assistant Secretary Andrew Cuomo will talk more about the details of the President's program.

The $5 billion Empowerment Zones program as passed in the House Reconciliation bill will include important tax incentives proposed by the President to encourage economic development. There are wage credits to encourage the hiring of zone residents both within and outside the zone. Expanded availability of tax exempt financing is provided to support the development of manufacturing, service and retail facilities in the zones. Increased capital expensing has been included to support small business investment Additional low income housing tax credits are provided to each zone to help alleviate the quality housing shortages common in these communities.

I am hopeful that the Reconciliation Conferees will report back to their respective bodies a bill with the tax incentives included by the House. I also hope that Congress will move quickly to put together an authorization that will put the framework and funding together to make the Empowerment Zones program the vanguard for urban policy that it can be. I wish that we could do more just as you, Mr. Chairman, advocated last year when we were addressing enterprise zones. But, I will work with the resources we now have available and continue to fight for more. The work of your committee will help advance us to reach these goals.

I look forward to working with you in an effort to make a difference in our inner cities.

Thank you.

Senator LIEBERMAN. Thank you, Congressman Rangel, for that brilliant, moving, powerful, right-on-target statement. I cannot think of a better beginning to these hearings.

As you know, we share your concern, and have a profound disappointment that the enterprise zone legislation was not part of what is going to come out of the Finance Committee.

I would just ask you one question, which is, is it fair to conclude that there is substantial support on the House side for this program and therefore that it is likely to be a priority at conference committee on reconciliation for the House negotiators?

Mr. RANGEL. Let me share a secret with you, Mr. Chairman. There is substantial support, overwhelming support, for the enterprise zones, but it is only because of what Senator Mack said. It would give these people hope.

I just have to be honest with you. Giving me as a Congressman 10 zones, 5 cities, 1 small city, an Indian reservation, and 3 rural areas is nothing I can take to a town hall meeting, except to say it

is a pilot project. We are trying to find out what poverty really is, and we understand there is some pain so we are going to experiment and find out what we can really do.

It is with a heavy heart that I say that if these programs really work, it would be the engine to what, an urban policy? I really do not see an urban policy. Is there back-up that is tied into this so that if it works in these 10 zones that we can now use it for the Nation to save money, lives? I do not see that anywhere.

But I tell you this, only because it provides hope for those who serve these constituents does a bill that a cap of saving or working with 750,000 Americans, who are all under the tax system—that is maxxed out—that we can say, hey, we are not slamming the door to this.

But I tell you, if you snuff out this light of hope—and take a look at the rest of the bill as it relates to these problems. You slash Medicare, where hospitals in inner cities depended on hospitals solely for their health care. You are slashing back the earned income tax credit. There is a cutback in food stamps. The stimulus package for jobs is on hold, and here we are, grown people talking about hope.

Yes, Mr. Chairman, you snuff out that hope, and then what are you going to point to in that package that we should vote for? And I tell you, when the eloquent argument is made for my friends in the Soviet Union yesterday, I do not think Americans deserve any less than we are willing to give the former communists.

Senator LIEBERMAN. Well said.

As you know, we are also upset about the small number of zones, and we will get into that with the next panel of witnesses, but whatever the forum, it is important to pass something and to create a little bit of hope here.

I will yield to Senator Mack and Senator Pressler, if they have any questions.

Senator MACK. I just want to say to you, Charlie, that was one of the most moving presentations that I have heard. I wish there was an opportunity for that message that you just gave us to be heard—and I use the word heard, as opposed to someone just listening, but heard by everyone in this country. I think that the concept of enterprise zones and the development of an urban policy would in fact flow out of it.

The expression of concern, compassion, feeling that you expressed today is, I think, something that would be moving for every Member of the Senate and the House. Again, I just appreciate your being here today and sharing that with us.

I gather from your response to Senator Lieberman's question that the President's proposal would provide hope, but I suspect from what you have had to say that you would want to see more enterprise zones.

I would ask you the question, though, do you believe that the proposal goes far enough in providing the capital incentives which I believe are necessary to make it work? Do you think it goes far enough? Should we be doing something different than what has been proposed?

Mr. RANGEL. Well, I do not see why you would increase the capital incentives if you are not willing to increase the money that is

necessary to create a climate for capital to move into these type of communities.

You know, if you keep following my logic, you can get down to one enterprise zone, and I told this to Darman. You can get down to the District of Columbia and say, do something here, my God, and then let the rest of the mayors find out what is working.

But it seems to me that having a whole lot of zones and not providing the funds to support that system does not make a lot of sense, because people will then say well, we tried to help those people and it is just a whole lot of wasted money. We have to make certain that it works.

By the same token, if you take the number of members of the Congressional Black Caucus, the Hispanic Caucus, the other representatives who represent poor areas that would be eligible for this type of treatment and divide that into 10, you know, which includes those who represent Indian reservations, it is pitiful. It is a shame.

It is difficult to say that it is anything else except a demonstration project, but we have to make certain that that works, because then I hope that we are able to come back and to show how much we are not spending on prisons and on cops and how much we are not spending on AIDS and on drugs, and how much we are not spending in our hospitals, and how much money we are making, where millions of people would be able to become productive citizens and pay taxes instead of each one costing us $1 million a year before they die.

So what I am saying is that it is difficult politically for me to do what I am doing, what members of the Congressional Black Caucus will be doing. You could take all of these zones and put it in one congressional district, but to show the unselfish nature of most of the Members in Congress, they say, hey, it is not that important whether it is Harlem or Detroit or Chicago or L.A., for God's sake do something different and invest up front.

So this bill is not going to rise and fall on how many zones you have, because we put together a bill that enlarged it to every community that met the criteria, and that was what Jack Kemp was talking about. At least make them eligible, and then of course you can have the second category as to who would get additional funds, and you can do that, then you have the third category where you just coordinate and relax the rules.

But you have got to have a sound foundation where you let everything go, all of the energies that we have for rebuilding Russia, to put that in these zones and let the mayors know and the Governors know and the private sector know that you have got to be with us and to have that plan and to be competitive.

So what I am saying, even with this limited amount of zones, Senator, there is not enough money to take care of that, and of course, the whole thing is cutting back and spending, and I would hate to see a situation where we take from one program and feed it into the other program and just have two half-funded programs.

In order to get our stimulus package for summer jobs, we took it from educational funds.

Senator Mack. Thank you.

Senator Lieberman. Senator Pressler, welcome.

Senator PRESSLER. I will not ask any questions except to compliment you and say I am very interested in this subject because of the Indian reservations in my State, and I have noted a change in attitude in the Indian reservations in the last 2 or 3 years.

I meet with tribal leaders every year, and this last year their two number one priorities were law and order and private economic development. That is something fairly new, because usually at those meetings I am harangued about more Federal aid or something of that sort, and we do have enormous problems on the reservations, but I think you are speaking out as we are opposites here, I suppose opposite parties, urban and rural, but our reservations have very similar problems to inner cities.

I have noted a change the last 2 or 3 years in what they are emphasizing. The leadership is starting to realize that 30 years of socialism—I do not want to get into an argument—does not work, and they are looking for something else.

So I am very proud to be a part of this hearing. I want to commend our Subcommittee Chairman, and I want to commend you, because I think we have some things in common if we can get it going.

Senator LIEBERMAN. Thank you, Senator Pressler. Charlie, again, thank you for your time and leadership. We look forward to working with you.

Mr. RANGEL. Could I have consent to have my written statement placed in the record?

Senator LIEBERMAN. Without objection, it would be a pleasure to do so.

The next panel—and we have a little bit of a timing problem, we are going to have to speed it up. I know Secretary Kemp, who is on the third panel, will have to leave at 11:30 a.m. I am going to call Andrew Cuomo and Maurice Foley, and we will move that along.

Senator LIEBERMAN. Gentlemen, I welcome you, and I know you have got to go over to the Finance Committee. Secretary Kemp has to be out of here by 11:30 a.m. I was inclined to call him first, because now that he is out of public life, his hourly rate has gone up so dramatically that I did not want to——

Mr. KEMP. $1.95 an hour.

[Laughter.]

Senator LIEBERMAN. Let us go right to your testimony. We will try to move it as quickly as we can and see if we can do this in about 15 or 20 minutes, and I would urge you to, if you can, do away with your opening statements. You are both highly eloquent.

The administration has taken a step in the right direction and put some real money on the table. Obviously, we are troubled that the Finance Committee is not going to go along with a lot of those figures but we hope it will come out in conference.

But what troubles us is the small number of zones and the lack of capital cost incentives and the number of cities that thereby will be left out. In a way this is a battle we went through before with Secretary Bentsen when he was Chairman of the Finance Committee and we ended with a larger number of zones and some capital cost incentives, which is why I was dismayed to see the administration proposal come back to where we were last year instead of now.

So let me ask you, if you can to address those questions, and this will be the beginning rather than the end of a dialogue.

STATEMENT OF MAURICE FOLEY, OFFICE OF TAX POLICY, U.S. DEPARTMENT OF THE TREASURY

Mr. FOLEY. Well, I will begin with the number of zones. That was one of the most difficult decisions that we had to make in putting together this package, but in deciding the number, which is 110 zones, 10 empowerment zones and 100 enterprise communities, we felt it was very important to carefully target the limited amount of resources that we have, and I have to emphasize that we do indeed have a limited amount of resources available.

We realized from the very beginning that these problems in distressed urban and rural communities have been around for a long time, and that it is not clear, although there is evidence on both sides, as to whether enterprise zones are going to be effective.

What is clear is that it is going to take more than tax incentives to solve this problem, and I think, Congressman Rangel, pointed out quite eloquently, that tax incentives alone will not do it. It is going to take a combination of spending programs and also a public-private partnership.

So we decided that it was best to set up what is indeed a demonstration program. It is limited to 10 zones that will have the bulk of the tax incentives, but we are going to closely monitor those zones and try and find out what works and what does not work and replicate our successes.

If you take a historical perspective and look back, you find that many of our previous urban policies, Model Cities, the Area Redevelopment Act, started out very small. The Area Redevelopment program was initially intended to cover a few dozen areas, but by the time President Kennedy signed the bill, one out of every five counties qualified, and a year later 1,000 counties were included.

If you look at the Model Cities program, that was initially designed to cover three or four cities, but it was expanded to cover about 120 cities, and we ended up wasting a lot of Federal resources.

I do not think anybody wants to make that mistake again, and I think we have taken a very prudent approach to the problem, and I think we have come up with a set of incentives that will solve these problems, or at least take a very good step in the right direction.

I realize that there are a lot of distressed areas out there—Newark, NJ, East St. Louis, IL, North Philadelphia, right here in Washington, DC—and the administration believes that it would be a tremendous accomplishment if we were able to revitalize 10 to 20 of those areas. It has not been done thus far.

I know this is an issue that is very important to you, and Connecticut has been at the forefront of enterprise zones. In fact, they had the first state-sponsored enterprise zone, but I think we have taken—we have done the best that we could with the amount of resources that we have available.

[The prepared statement of Mr. Foley follows:]

Prepared Statement of Maurice B. Foley

Chairman Lieberman and Members of the Committee: I am pleased to have this opportunity to present testimony today concerning the Administration's Empowerment Zone and Enterprise Community initiative. The Administration's original proposal, as submitted as part of the budget, was modified slightly by the Ways and Means Committee. That modified version was included in H.R. 2264 as approved by the House of Representatives on May 27, 1993.

My testimony today will describe for you the major features of the Administration's proposal. Before I get to that, however, I would like to outline some of the general objectives and principles that were critical to the development of the proposal.

GENERAL OBJECTIVES AND GUIDING PRINCIPLES

A. Tax Incentives As Part Of A Broader Strategy

The Administration believes that special consideration should be given to the problems of socially and economically distressed urban and rural areas. A major objective of the Administration's proposal is to encourage increased business activity in these areas by overcoming impediments to economic development, such as high crime rates, inadequate public services, and a poorly educated and unskilled labor force. A number of these impediments may be more appropriately addressed by specific expenditure programs developed at the local level by private organizations and local governments.

It is important to recognize that no combination of tax incentives will solve the myriad of social and economic problems confronting these areas. Thus, the federal income tax incentives that are proposed by the Administration represent only one component of a more comprehensive approach to addressing these problems. The President has established a working group on Community Empowerment, chaired by the national Economic Council. This working group consists of representatives from the Departments of Housing and Urban Development (HUD), Labor, Health and Human Services, Agriculture and Treasury, the Office of Management and Budget, the Small Business Administration, and other agencies. The Administration also is currently working with Congress on a community development bank initiative, welfare reform, and other legislative initiatives, including a spending proposal to direct existing resources under current federal programs to the 110 empowerment zones and enterprise communities (hereinafter referred to collectively as "enterprise zones"). Andrew Cuomo from HUD has discussed this particular proposal in more detail.

The federal enterprise zone initiatives will be coordinated by an inter-agency Enterprise Board. To further broaden the impact of this program, State and local governments are required to work closely with local organizations and other private interests to develop a strategic plan for improving the conditions in a nominated area before that area is eligible for designation as enterprise zone.

The Administration's proposal is intended to attract and support small, large, new and existing businesses. We recognize that tax incentives are unlikely to influence the behavior of smaller and newer businesses that do not generate significant tax liabilities. These businesses, however, will receive assistance from our community development bank proposal, Treasury's program to relieve the credit crunch, and programs sponsored by the Labor Department and HUD.

B. *Emphasis on Labor Incentives.* Tax incentives can operate to lower the cost of the two primary inputs for business—labor and capital. The Administration has proposed a tax incentive package that emphasizes subsidies for labor for two principal reasons. First, labor tends to represent a larger operating cost than capital for most businesses. Second, labor subsidies directly encourage higher employment, which is a key economic goal of the initiative, while capital subsidies only do so indirectly.[1]

Modest capital incentives for investments in tangible assets are also included. These incentives will encourage the construction and rehabilitation of commercial and residential real estate and the purchase of capital equipment. In addition to these incentives, the Administration's budget proposal also included a capital gains investment incentive not limited to, but nevertheless applicable to, investments in certain enterprise zone businesses.

Our emphasis on labor incentives is supported by studies which indicate that the vast majority of generous capital subsidies benefit the existing owners of capital,

[1] See, for example, the evaluation by the Congressional Research Service entitled "Enterprise Zones: The Design of Tax Incentives."

with only modest, indirect benefits accruing to the labor force. Indeed, emphasizing capital subsidies may lead to lower employment levels because businesses are encouraged to shift from labor intensive to capital intensive operations.

C. *Balancing Effective Incentives And Budgetary Constraints.* Among the more difficult decisions reached in developing the Administration's proposal involved the number of empowerment zones to recommend. Budget constraints severely restrict the resources available for the program. Another consideration is the absence of conclusive evidence regarding how large federal incentives must be to attract significant business activity. In addition, we believe that limiting the number of empowerment zones will greatly enhance the government's ability to monitor the impact that various federal tax incentives and spending initiatives have in distressed areas. This evidence will allow the government to determine which initiatives have the greatest impact, and will enable the government to duplicate successes in a cost-efficient manner. For these reasons, the Administration's proposal recommends a two-tiered approach, involving the designation of 10 empowerment zones and 100 enterprise communities. We believe that an increase in the number of proposed enterprise zones, accompanied by a dilution of the incentives, would significantly reduce the potential for the success of this program.

DESCRIPTION OF PROPOSAL

A. Designation of Enterprise Zones

1. *In general.* As many as 110 enterprise zones, allocated between 10 empowerment zones and 100 enterprise communities, would be designated in 1994 and 1995. A zone may be either an urban zone, a rural zone, or an Indian reservation zone. Zones would be designated only from areas nominated by State and local governments or a governing body of an Indian reservation, and must meet certain specified objective criteria.

The Secretary of HUD, in consultation with the Enterprise Board, would designate up to 71 urban zones. Of this number, as many as 6 may be designated as empowerment zones. Of the urban empowerment zones, at least 1 would be in an urban area with a population of 500,000 or less. In addition, the total population within all the urban empowerment zones may not exceed 750,000 at the time of designation.

Similarly, the Secretary of Agriculture in consultation with the Enterprise Board would designate up to 33 rural zones, with as many as 3 designated as empowerment zones. The Secretary of the Interior in consultation with the Enterprise Board would designate up to six Indian reservation tax enterprise zones, one of which may be designated as an empowerment zone.[2]

Zone designations generally would remain in effect for 10 years. An area's zone designation may be revoked if the local government or State significantly modifies the boundaries or does not comply with its agreed-upon strategic plan for the zone (as described below).[3]

2. *Eligibility criteria for zones.* To be eligible for designation, a nominated area is required to satisfy all of the following objective criteria.

Population limits. A nominated area must have a population of at least 15,000 (5,000 for rural zones and no population minimum for Indian reservation zones) and a population no greater than the lesser of (a) 200,000, or (b) 10 percent of the total population of the city (30,000 for rural zones and no population maximum for Indian reservation zones).[4]

Geographic limitations. A nominated area must be contained within (a) a continuous boundary or, except in the case of a rural area located in more than 1 State, not more than 3 noncontiguous areas, (b) in the case of an urban zone, not more than 2 States (in the case of a contiguous rural zone, not more than 3 contiguous States), (c) no more than 20 square miles (1,000 square miles if a

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[2] Rural enterprise zones will be located in areas that are (1) outside a metropolitan statistical area as defined by the Secretary of Commerce, or (2) determined by the Secretary of Agriculture to be a rural area. Indian reservation enterprise zones must be located on a "reservation" as defined in either section 3(d) of the Indian Financing Act of 1974 (25 U.S.C. 1452(d)), or section 4(10) of the Indian Child Welfare Act of 1978 (25 U.S.C. 1903(10)).

[3] An area's designation as a zone may be revoked only after a hearing on the record at which officials of the State and local governments (or Indian reservation) are given an opportunity to participate and the governments have an opportunity to correct any deficiencies found at the hearing. Any such revocation may take effect only on a prospective basis.

[4] In the case of an urban area in which the most populous city has a population of less than 500,000, the zone may have a population of up to 50,000 (*i.e.*, instead of being subject to the 10 percent cap).

rural zone or an Indian reservation zone) and (d) an area that does not include any portion of a central business district that has a poverty rate less than 35 percent.

General distress. A condition of pervasive poverty, unemployment and general distress (indicated by factors such as high crime rates or designation of the area as a disaster area) must be present in each nominated area.

Poverty rates. Each nominated area must have poverty rates of at least 20 percent in each of the area's census tracts, poverty rates of at least 25 percent in at least 90 percent of the census tracts, and poverty rates of at least 35 percent in at least 50 percent of the census tracts.[5]

3. *Strategic plan.* In order for a nominated area to be eligible for designation as an enterprise zone, the local government and State in which the area is located would be required to agree in writing that they would adopt (or continue to follow) a strategic plan designed to advance the objectives of the federal enterprise zone proposal. The strategic plan must [6] (a) describe the coordinated economic, human, community and physical development plan and related activities proposed for the nominated area, (b) describe the community participation process and the extent to which local institutions and organizations have contributed to the planning process, (c) identify the amount of State, local, and private resources that would be available in the nominated area and the private/public partnerships to be used (which may include participation by, and cooperation with, universities, community development corporations, and other private and public entities), (d) identify the funding requested under any federal program in support of the proposed economic, human, community, and physical development and related activities, (e) identify baselines, methods, and benchmarks for measuring the success of carrying out the strategic plan, and (f) not include any action to assist any establishment in relocating from one area outside the nominated area to the nominated area.[7]

4. *Selection process and criteria.* In designating zones from among the nominated areas, the appropriate Secretary would take into account the effectiveness of the strategic plan submitted and the assurances from the State and local governments that the strategic plan will be implemented. In addition, the Enterprise Board may identify additional criteria to be considered in the designation process.

B. Description of tax incentives

The Administration's proposal contains 7 tax incentives, all of which would be available in empowerment zones and 3 of which would be available in enterprise communities. These incentives are divided among labor incentives, capital incentives, and a savings incentive, and would be available as follows:

- Incentives available in empowerment zones:
  - Labor Incentives:
    - Wage and training credit
    - Expansion of targeted jobs tax credit
  - Capital Incentives:
    - Increased section 179 expensing
    - Accelerated depreciation
    - Qualified enterprise zone facility bonds
    - Low-income housing credit expansion
  - Saving Incentive:
    - Zone resident empowerment savings credit
- Incentives available in enterprise communities:

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[5] Each noncontiguous area of a zone must satisfy these poverty requirements. In addition, there are special rules for applying the poverty rate requirements. A census tract with no population is treated as satisfying the 20-percent and 25-percent poverty rate requirements, but is considered to have a zero poverty rate for purposes of the 35-percent poverty rate requirement. The designating Secretary may reduce by 5 percentage points either the 20-percent, 25-percent, or 35-percent poverty rate requirement for up to 10 percent of the zone's census tracts (or, if fewer, 5 census tracts).

[6] Required elements of a strategic plan apply to an area located on an Indian reservation only to the extent that the reservation governing body has legal authority to comply with such requirements.

[7] This limitation does not prohibit assistance for the expansion of an existing business entity through the establishment of a new branch, affiliate, or subsidiary if (1) the establishment of the new branch, affiliate, or subsidiary will not result in a decrease in employment in the area of original location or in any other area where the existing business conducts operations, and (2) there is no reason to believe that the new branch, affiliate or subsidiary is being established with the intention of closing down the operations of the existing business in the area of its original location or in any other area where the existing business conducts operations.

Capital Incentives:
- Qualified enterprise zone facility bonds
- Low-income housing credit expansion

Saving Incentive:
- Zone resident empowerment savings credit

1. Labor Incentives

Employment and training credit. A 25 percent credit against income tax liability would be available to all employers for the first $20,000 of wages paid to each employee who (1) is a zone resident (*i.e.*, his or her principal place of abode is within the zone [8]), and (2) performs substantially all employment services within the zone in a trade or business of the employer.[9] This credit would encourage the employment of zone residents by lowering the cost of labor for zone businesses.

To reduce the long-term cost of the credit, the rate of the credit is phased down after 7 years by 5 percentage points per year. Thus, the maximum credit in 2001 would be 20 percent of the first $20,000 of wages, in 2002 it would be 15 percent of such wages, in 2003 it would be 10 percent of such wages, and in 2004 it would be 5 percent of such wages.

The maximum credit per qualified employee would be $5,000 per year (prior to the phase down period). Wages paid to a qualified employee would continue to be eligible for the credit if the employee earns more than $20,000, although only the first $20,000 of wages would be eligible for the credit.[10] The wage credit would be available with respect to a qualified employee, regardless of the number of other employees who work for the employer or whether the employer meets the definition of an "enterprise zone business" (which applies for certain other tax incentives described below). In addition, the credit is allowable to offset up to 25 percent of alternative minimum tax liability.

Qualified wages would include the first $20,000 of "wages," defined as (1) salary and wages as generally defined for FUTA purposes, and (2) certain training and educational expenses paid on behalf of a qualified employee, provided that (a) the expenses are paid to an unrelated third party and are excludable from gross income of the employee under section 127, or (b) in the case of an employee under age 19, the expenses are incurred by the employer in operating a youth training program in conjunction with local education officials.

The credit would be allowed with respect to both full-time and part-time employees. However, the employee must be employed by the employer for a minimum period of at least 90 days. Wages are not eligible for the credit if paid to certain relatives of the employer or, if the employer is a corporation or partnership, certain relatives of a person who owns more than 50 percent of the employer. In addition, wages would not be eligible for the credit if paid to a person who owns more than five percent of the stock (or capital or profits interests) of the employer. An employer's deduction otherwise allowable for wages paid would be reduced by the amount of credit claimed for that taxable year.

In designing this incentive, careful consideration was given to an incremental credit intended to encourage only increased levels of employment. The primary argument in favor of an incremental wage credit is that, in theory, it is a more cost-effective incentive. However, we rejected such an approach for three reasons. First, an incremental credit would be much more complex than a flat credit. As a result, many businesses (particularly small businesses) would not take advantage of it or would not comply with its intricate requirements. Second, unlike a flat credit, an incremental wage credit provides no support for existing businesses that employ zone residents. We believe that preserving such businesses is very important to a successful revitalization effort. Third, a major problem with distressed areas is that businesses typically leave the area once they become successful. A flat wage credit, as opposed to an incremental credit, would encourage successful businesses to stay.

Expansion of targeted jobs tax credit. The targeted jobs tax credit (TJTC) would be expanded under the Administration's proposal so that a person who resides in an

[8] Employers are expected to undertake reasonable measures to verify an employee's residence within the zone, so that the employer will be able to substantiate any wage credit claimed.

[9] The credit is not available, however, with respect to any individual employed at any facility described in present-law section 144(c)(6)(B) (*i.e.*, a private or commercial golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack or other facility used for gambling, and any store the principal business of which is the sale of alcoholic beverages for consumption off premises).

[10] To prevent avoidance of the $20,000 limit, all employers that are members of a controlled group of corporations (or that are partnerships or proprietorships under common control) would be treated as a single employer.

enterprise zone would be a member of a targeted group for purposes of that credit. This credit would encourage businesses both inside and outside the zones to hire zone residents. However, an employer could not claim both a TJTC and a zone wage credit with respect to an employee's wages in the same taxable year. Thus, employers located outside empowerment zones are entitled to claim the 40-percent TJTC on up to $6,000 of qualified first-year wages paid to employees who reside within an empowerment zone. Similarly, employers located within empowerment zones may claim the TJTC with respect to a new employee who resides within an empowerment zone as long as such employee's wages are not taken into account in determining the employer's zone wage credit for that taxable year. An employer's deduction otherwise allowed for wages is reduced by the amount of TJTC claimed for that taxable year.

2. Capital Incentives

Eligible businesses. Unlike the labor incentives described above, the capital incentives described below would be available only with respect to trade or business activities that satisfy the criteria for an "enterprise zone business." These limitations are designed to target the capital incentives to businesses that are likely to have a significant economic impact in the zone, while limiting the possibility of abuse. An "enterprise zone business" would be a corporation, partnership, or proprietorship if, for the taxable year, the following conditions are satisfied: (1) the sole trade or business is the active conduct of a "qualified business" (described below) within an enterprise zone,[11] (2) at least 80 percent of the total gross income is derived from the active conduct of a qualified business within a zone; (3) substantially all of the use of its tangible property occurs within a zone; (4) substantially all of its intangible property is used in, and is exclusively related to, the active conduct of such business; (5) substantially all of the services performed by employees are performed within a zone; (6) at least 35 percent of the employees are residents of the zone [12]; and (7) no more than five percent of the average of the aggregate unadjusted bases of the property owned by the business is attributable to (a) certain financial property, or (b) collectibles not held primarily for sale to customers in the ordinary course of an active trade or business.[13]

A "qualified business" is any trade or business other than a trade or business that consists predominantly of the development or holding of intangibles for sale or license, or a business consisting of the operation of a facility described in section 144(c)(6)(B) (*i.e.*, a private or commercial golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack or other facility used for gambling, and any store the principal business of which is the sale of alcoholic-beverages for consumption off premises). Farming is also excluded unless the unadjusted basis of the assets used by taxpayer in the business total $500,000 or less. In addition, the leasing to others of any structure or building located within an enterprise zone is not treated as a qualified business if less than 50 percent of the gross rental income from the building or structure is derived from property leased to enterprise zone businesses. The rental of tangible personal property to others is not a qualified business if less than substantially all of the gross rental income from such property is from enterprise zone businesses and from residents of an enterprise zone.

Activities of legally separate (even if related) parties are not aggregated for purposes of determining whether an entity qualifies as an enterprise zone business. Notwithstanding the particular incentives described below, investments in enterprise zone businesses are subject to the general loss limitation rules (*e.g.*, the passive loss rules and the at-risk limitations).

Certain of the investment incentives impose limitations based on the type of tangible property used in an enterprise zone business. Such property, referred to as "qualified zone property," is depreciable tangible property (including buildings), provided that: (1) such property is acquired by the taxpayer from an unrelated party after the zone designation takes effect; (2) the original use of the property in the

[11] This requirement does not apply to a sole proprietorship.

[12] For this purpose, the term "employee" includes a self-employed individual (within the meaning of section 401(c)(1)).

[13] An activity will cease to be a qualified enterprise zone business as of the date on which the designation of the enterprise zone in which the activity is conducted is terminated, except that the activity will continue to be a qualified enterprise zone business with respect to (1) the first taxable year of such activity, (2) any property placed in service before the date of termination of the zone designation, and (3) any property placed in service after the date of termination pursuant to a binding, written contract in effect before the termination date (and at all times thereafter).

zone commences with the taxpayer [14]; and, (3) substantially all of the use of the property is in the active conduct of an enterprise zone business. In the case of property which is substantially renovated by the taxpayer, however, such property need not be acquired by the taxpayer after zone designation or originally used by the taxpayer within the zone if during any 24-month period after zone designation, the additions to the taxpayer's basis in such property exceed the greater of 100 percent of the taxpayer's basis in such property at the beginning of the period or $5,000.[15]

Increased section 179 expensing. The expensing allowance for certain depreciable business property provided under section 179 would be increased from $10,000 to $75,000 and extended to all qualified zone property, including buildings. This increase in the expensing allowance would lower capital costs for small zone businesses and thereby encourage investment.

As under present law, the section 179 expensing allowance is phased out for certain taxpayers with investment in depreciable business property during the taxable year above a specified threshold. For the allowance claimed with respect to qualified zone property, the phaseout range is increased to $200,000-$350,000 of investment (exclusive of buildings) made by the taxpayer during the taxable year.

Also as under present law, all component members of a controlled group are treated as one taxpayer for purposes of the $75,000 limitation and the phaseout. The $75,000 expensing allowance applies at both the partnership and partner levels.

The increased expensing allowance applies for purposes of the alternative minimum tax (*i.e.*, it would not be treated as an adjustment for purposes of the alternative minimum tax). The allowance claimed with respect to qualified zone property would be recaptured if the property is not used predominantly in an enterprise zone business (under rules similar to present-law section 179(d)(10)).

Accelerated depreciation. An enterprise zone business would determine its depreciation deductions with respect to qualified zone property (other than such property that is expensed under section 179) by using the following recovery periods:

3-year property	2 years
5-year property	3 years
7-year property	4 years
10-year property	6 years
15-year property	9 years
20-year property	12 years
Nonresidential real property	22 years

By lowering capital costs primarily for larger businesses, allowing accelerated depreciation would encourage investment in the zone. The shorter recovery periods allowed for qualified zone property of enterprise zone businesses would be allowed for alternative minimum tax purposes.

Qualified enterprise zone facility bonds. A new category of tax-exempt private activity bonds would be authorized for use in empowerment zones and enterprise communities. "Qualified enterprise zone facility bonds" are bonds 95 percent or more of the net proceeds of which are to be used to provide (1) qualified zone property for an enterprise zone business, and (2) land located in the zone the use of which is functionally related and subordinate to such a business. Qualified enterprise zone facility bonds would be exempt from the general restrictions on financing the acquisition of land and existing property (section 147(c)(1)(A) and (d)).

The aggregate face amount of qualified enterprise zone facility bonds allocable to any enterprise zone business may not exceed $3 million with respect to a particular zone. In addition, the aggregate face amount of qualified enterprise zone bonds allocable to an enterprise zone business in all zones may not exceed $20,000,000. Bonds satisfying these requirements may be pooled and sold as part of a larger issue.

In certain circumstances an issue of qualified enterprise zone facility bonds would continue to be treated as tax-exempt bonds despite the fact that the issue ceases to satisfy the requirements relating to financing qualified zone property for an enterprise zone business. This rule would apply if the issuer and the borrower in good faith attempted to satisfy the applicable requirements and any noncompliance is corrected within a reasonable period after the discovery of the non-compliance. However, no deduction would be allowed for interest on any tax-exempt financing

[14] Thus, used property may constitute qualified zone property, so long as it has not previously been used within the enterprise zone.

[15] Qualified zone property does not include any property to which the alternative depreciation system under section 168(g) applies, determined (1) without regard to section 168(g)(7), and (2) after application of section 280F(b).

for any period in which the financed facility ceases to be used in a zone or the principal user ceases to be an enterprise zone business.[16]

Qualified enterprise zone facility bonds are allowed a 50-percent exclusion from the otherwise applicable State private activity bond volume limitations. For a business in an empowerment zone, more than 50 percent of which is owned by residents of that zone, the bonds are allowed a 75-percent exclusion from the otherwise applicable State private activity bond volume limitations.

The general rule requiring banks to forego a portion of their otherwise allowable interest expense deduction if they invest in tax-exempt bonds does not apply to investments in qualified enterprise zone facility bonds.

Low-income housing credit expansion. For purposes of the low-income housing credit (LIHC), census tracts with poverty rates of 30 percent or more within an empowerment zone or enterprise community would automatically qualify as "difficult to develop" areas, as defined under section 42(d)(5)(C). In such tracts the eligible basis of buildings for purposes of computing the credit is 130 percent of the cost basis. Thus, for LIHC projects in zones, the credit would be based on 91 percent of present value instead of the regular LIHC rate of 70 percent of present value. The State credit cap would continue to apply.

3. Saving Incentive

Zone resident empowerment savings credit. A 50 percent credit would be available for a zone employer's contribution to a defined contribution retirement plan on behalf of employees who (1) are zone residents and (2) perform substantially all employment services within the zone. The contribution eligible for the credit would be capped at 2 percent of the amount of the employee's compensation up to $35,000 per year. The employer's credit would be in addition to any employment and training credit (described above). Employers could make such contributions to the plan unilaterally or match an employee's contribution. This incentive would be available for all zone employers. The retirement plan would have to be a qualified defined contribution plan, other than an ESOP or stock bonus plan. Small employers could make their contributions to simplified employee pensions. The employer contribution would be required to be 100 percent vested.

OTHER RELEVANT BUDGET PROPOSALS

A. Targeted Capital Gains Exclusion. The Administration's budget proposal also contains a significant incentive for investments in small businesses. Under the proposed targeted capital gains exclusion, noncorporate investors who hold qualified small business stock for at least 5 years would be permitted to exclude 50 percent of gains realized on the disposition of their stock. A qualified small business is a subchapter C corporation with less than $50 million of aggregate capitalization from January 1, 1993, through the date the taxpayer acquires stock in the corporation, that uses substantially all of its assets in the active conduct of a trade or business during substantially all of the taxpayer's holding period.[17] Qualified small business stock must be acquired directly by an individual taxpayer (or indirectly by an individual taxpayer through an investment partnership or other pass-through entity) after December 31, 1992, and at its original issue (either directly from the corporation or through an underwriter). Subchapter C corporations that hold stock in a qualified small business would not qualify for the exclusion.

Individuals would be allowed to exclude 50 percent of capital gains realized upon the disposition of qualified small business stock held over 5 years, and would apply their current statutory rate on capital gains (either 15 or 28 percent) to the reduced amount of taxable gain. Gain eligible for the exclusion would be limited to the greater of ten times the investor's basis in the stock or $10 million for each qualified small business. One half of any exclusion claimed would be treated as a tax preference item under the individual alternative minimum tax.

B. *Expansion of the Earned Income Tax Credit.* Under the Administration's budget proposal, the earned income tax credit (EITC) would be expanded and increased by the amount necessary, when combined with a full-time, minimum wage job and available food stamps, to lift a four-person family out of poverty. This proposal would have a significant impact upon low-income workers living in distressed areas. The increase in the credit amount would be phased in over a 2-year period

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[16] The termination of an empowerment zone's designation or any noncompliance due to bankruptcy would not result in the loss of tax-exempt status of the bonds or the application of the interest deduction disallowance rules.

[17] Certain activities, including personal service, banking, leasing, real estate, farming, mineral extraction, and hospitality businesses, cannot be qualified small businesses.

beginning after 1983. As under current law, the income thresholds for both the phase-in and phase-out ranges would be adjusted each year for changes in the cost-of-living.

The basic credit when fully phased-in would be increased for families with one child to 34.4 percent of the first $6,000 of earned income (in 1994 dollars). Therefore, the maximum basic credit amount for families with one qualifying child would be $2,062 (34.4 percent of $6,000).[18]

The basic credit would be phased-out once adjusted gross income (or, if greater, earned income) exceeds a certain threshold. The phase-out range for families with one child would begin at $11,000, a lower level than current law, but would end at $23,760, the same as projected under current law. The phase-out percentage would be 16.16 percent.

The basic credit percentage would also be increased for families with two or more qualifying children. When fully phased-in, the basic credit percentage would be increased to 39.7 percent of the first $8,500 of earned income. Filers with earnings between $8,500 and $11,000 would be entitled to the maximum credit of $3,371 (39.7 percent of $8,500).

The phase-out percentage for these families would be increased to 19.83 percent. As in the case of the credit for families with one child, the credit would be phased out starting at $11,000. However, the phase-out range for families with two or more children would extend to $28,000, an increase of $4,240 over current law.[19]

The EITC would also be extended for the first time to low-income workers who do not have children. Qualifying workers must be age 22 or older and may not be claimed as a dependent on another taxpayer's return. For these workers, the basic credit would be 7.65 percent of their first $4,000 of earned income. In 1994, the phase-out range for these workers would be between $5,000 and $9,000 of adjusted gross income (or, if greater, earned income). The phase-out percentage would also be 7.65 percent.

The current-law supplemental young child credit and the supplemental health insurance credit would be repealed.

This concludes my prepared remarks. I would be pleased to respond to your questions.

Senator LIEBERMAN. I appreciate that beginning. We will do some questioning on it.

Mr. Cuomo, Assistant Secretary of HUD, we welcome you.

STATEMENT OF ANDREW CUOMO, ASSISTANT SECRETARY, U.S DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Mr. CUOMO. It is a pleasure to be here.

On the point that you raised, Mr. Chairman, as Maurice Foley said and as Congressman Rangel so eloquently spoke before we had the opportunity to come to the panel, what this proposal says is, first the engine that will drive revitalization of a distressed area is an economic engine.

The economic engine can be spurred by enterprise zones, as we know from experience, as your experience in Connecticut points out. We know from the articulate points that were made by then—Secretary Jack Kemp, who will also be here today, economic opportunity must exist. Tax incentives help that. Enterprise zones help that.

However, as Congressman Rangel said, we think that is one-half of the equation. Tax incentives alone are not enough to attract businesses to severely distressed areas. You have to show them that the area as a whole has a plan for revitalization, otherwise it

[18] For 1994, the Administration's proposal would increase the basic credit to 26.6 percent of the first $6,000 of earned income.

[19] For 1994 the credit rate would be increased to 31.6 percent of the first $8,500 of earned income, and the phase-out percentage would be 15.8 percent. The phase-out range would extend from $11,000 to $28,000.

does not make sense from a business point of view to go in, no matter what the incentive package is.

Even if you did seduce business into a distressed area just because of tax incentives, the people who live in the zone, the people you are trying to help, probably would not be in a position to take advantage of that economic opportunity without assistance, without the proper training to be a meaningful employee that has a job that pays a wage that is more meaningful than welfare without the day care, et cetera, without the schools, the transportation.

We say you need two parts of the equation: (a) the tax incentives, enterprise zones, (b) a meaningful plan for revitalization for that area, a plan that is driven by the local community, that is written by the local government and is not dictated to from Washington.

That then gets into a question of spending. As Maurice and as Congressman Rangel pointed out, you have a limited number of resources on the table. We believe the worst thing to do at this point would be to embark on yet another effort to try to help distressed areas and fail.

With the current configuration that is before you, the 10 so-called large zones, the empowerment zones, have about $30 million of spending per zone on the large zones, on the spending side. $30 million will be for an area up to 20 square miles.

As many as 200,000 people in an area like Bedford-Stuyvesant, Brooklyn, which is a very distressed area, $30 million for an area about 8, 10 square miles is not an excessive amount of spending. South Central L.A., $30 million in an area that could be as large as 20 square miles is not a lot of money.

The caution that we would point to on the number of zones is—and the Model City demonstration provides guidance on this one—the tendency is to increase the number of cities, increase the number of zones, but the amount of resources does not increase. That is a formula for failure in a program such as this one. That was one of the cautions that led us to the configuration we proposed.

[The prepared statement of Mr. Cuomo follows:]

Prepared Statement of Hon. Andrew Cuomo

It is a pleasure to testify before this committee on the topic the Administration's proposal on Empowerment Zones and Enterprise Communities. This proposal is part of a larger strategy to revitalize distressed American cities, small towns and rural areas and to help residents of these areas rejoin the mainstream of American life. It is about jobs and people who need them. Mr. Chairman, you are certainly familiar with the enterprise concept because Connecticut has had a program for more than 10 years and you are the author of an Enterprise Zone bill.

Enterprise zones address a number of national problems. A key problem is that the old manufacturing jobs that have served as the life blood of the major American cities have eroded. Industrial plants have fled to the suburbs, to the South, or closed forever because of the free movement of capital in the new "global village". The erosion of jobs from center cities and small towns has been one contributing factor to an increase in poverty because of the loss of access to these jobs by the segregated minorities and poor families. In 1991, the U.S. poverty count stood at 35.7 million persons, up by around 4 million from 1989.

In addressing these problems, the Administration's proposal builds upon prior proposals, but adds a number of fresh new elements. The legislation calls for designation of (a) 10 Empowerment Zones which have access to higher amounts of grant assistance and in-depth tax incentives for businesses and (b) 100 Enterprise Communities which would receive some more modest tax incentives and some grants.

Comprehensive economic and human development. The assumptions of this legislation are quite different from earlier proposals which focused primarily on tax incentives. Our founding premise is two fold: economic development must provide the engine to drive recovery, but meaningful economic development can only succeed when coupled with a comprehensive program for physical and human development. We believe that industry and businesses will not locate on a sufficiently large scale in highly distressed areas simply for benefits derived from tax incentives. Economic, physical and human development must go hand in hand to trigger genuine revitalization of these areas.

To achieve this comprehensive approach, a condition of assistance is that each application must include a strategic plan. The plan must be "community based" and describe the coordinated economic, human, community, and physical development of the empowerment zone or enterprise community. It is a "bottom up" rather than a "top down" approach.

To implement the plans, a $500 million challenge grant is proposed for the Empowerment Zones and Enterprise Communities. This grant provides the means for a "one stop shopping" approach. It is designed to be sufficiently flexible to carry out the array of activities necessary for the successful economic and human development of the zone or community. Chief among these are activities that will increase job sand businesses; assist residents to obtain jobs and economic opportunities within the zone, community and throughout the region; address problems of security; and achieve educational goals. Most of the challenge grant funds would go to the 10 major Empowerment Zones, but a portion would be allocated among the 100 Enterprise Communities.

In addition, we have sought $238 million for each Fiscal year 1993 and 1994 for special safety and security grants to increase police presence, to expand and improve cooperative efforts between law enforcement and the community to improve public safety. Priority will go to Empowerment Zones and Enterprise Communities.

Improving government effectiveness. The program will also permit us to test holistic approaches to addressing a wide array of problems of low-income individuals, families, and neighborhoods. The comprehensive approach applied in Empowerment Zones and Enterprise Communities will permit experimentation with inter-agency and inter-program cooperation. To facilitate inter-agency cooperation, we have proposed an Enterprise Board consisting of the heads of 14 Federal agencies, plus other members. The Board would be given the authority to waive certain statutory or regulatory provisions of the Federal programs that will be used in the zones or communities, providing that these waivers do not conflict with the statutory purposes of the particular Federal program for which waivers are requested.

Effectiveness of incentives. Mr. Chairman, in your letter to the Secretary, you asked *if this proposal appropriately focuses on barriers to small business development and jobs created in inner cities and rural communities?* You also *asked if the incentives are structured in a way that will enable them to be fully utilized by small firms?*

Treasury will deal with the tax issues in more detail, but I believe that the answer is "yes" to both questions. Although small businesses are not singled out for special treatment, the incentives proposed are particularly well-suited for small businesses. The major incentive in the Empowerment Zones is the employment credits providing substantial tax relief for firms who are employing persons who live and work in the zone and are earning less than $20,000. This tax incentive will be well-suited to small firms. The focus of this major incentive is on jobs, rather than investment. Other prior tax proposals would depend upon future sale or profitability to obtain tax benefits.

We believe that the other tax incentives in the zones and communities will also be helpful to small businesses both in the empowerment zones and enterprise communities. All of these incentives should reduce the cost of doing business in the zones for both large and small firms.

The new block grant that will be available in the zones and communities can also be focused on encouraging the formation and expansion of new and existing small firms. Revolving loan programs (including micro-business loans), seed capital, technical assistance programs, small business incubators and other programs could be funded with these grants. In addition, small businesses should have enhanced access to economic development programs of the Small Business Administration, the Department of Commerce, and HUD.

Broader economic impact. Mr. Chairman, you also asked if the 10 empowerment zones appropriately respond to the economic crisis in urban and rural communities Nationwide?

In responding to this question, I must point out that we are proposing to fund 110 zones and communities, not just 10 zones. They will be widely distributed geographically and by community type: urban, rural and Indian. In addition, the Empowerment Zone and Enterprise Community package is only one small part of the President's effort to stimulate the economy.

A small number of zones was selected for special emphasis because, due to the huge overhanging deficit, we do not have enough money to fully revitalize 100 or 200 areas. I believe that the experience of the Model Cities program indicates that it is better to do the job right in a few communities than to spread our resources so thinly so that little progress is made in any community. Further, in light of past failures to stimulate urban revitalization, if we can find some approach that is effective, this will be of great boon to the Nation.

This is related to the final question which you ask: *What are the prospects for expansion of the program in future years?*

The answer to that question depends upon the success with the first round projects and future budget circumstances. However, we are hopeful for a second or even a third round.

Thank you for giving me the opportunity to make this presentation. I would be happy to respond to any further questions.

Senator LIEBERMAN. Thank you for your statement. We have been involved in the concept of empowerment for a longtime. Actually Senator Robert Kennedy introduced a bill, it was not called enterprise zones in 1967, which was very much like this, using tax incentives to bring businesses to poor urban areas.

The recommendation of the administration is a milestone in many ways, in the first place because of the resources committed to it. You have $8.1 billion over 5 years, $4.1 billion in tax incentives and $4 billion in associated grants, and I like the idea that you have a two-part proposal here, and I agree with the policy underpinnings to that. My concern again is about why focus is on only 10 genuine enterprise zones when the need is so enormous.

Let me ask you a little bit about the need first. There are eligibility criteria set up in the proposal. You have some objective criteria for eligibility. You have got to pass that threshold, and then you submit your plan, and then the Government chooses. Good idea—get the public/private/Government all together to submit the plan.

Do you have any idea of how many urban and rural areas would qualify under the eligibility standards, in other words would pass that first threshold?

Mr. FOLEY. Well, last year under the administration's plan, which had stricter poverty criteria than we have in our administration's proposal, they contended that over 300 communities would qualify. I would think that a similar number would qualify under our proposal.

Senator LIEBERMAN. Perhaps more, because those criteria were stricter.

Mr. FOLEY. That is correct.

Senator LIEBERMAN. So there again, I think by that objective standard we see that the need out there is in at least 300 communities, and we are essentially limiting it to 10 for what I would consider to be genuine enterprise zones.

Now, part of this I think is premised on the fact that this is a demonstration project and maybe that is part of where we disagree.

One of the witnesses before our Committee last year said that never in the history of domestic policymaking have literally hun-

dreds of cities demonstrated the principles of a Federal program before Congress authorized its full operation.

We are confident that we understand the way enterprise zones perform. Thus we can confidently urge Congress to implement the Federal policy in more than a handful of communities.

Do I take it that you disagree with that statement?

Mr. Foley. We believe it is very difficult to compare the State experience to the Federal level. There are significant differences between the types of incentives that are available at the State level and the incentives that will be available under any Federal program.

Most State programs offer a reduction in franchise fees, property taxes, and State corporate taxes. These taxes are generally a much smaller expense than Federal taxes, for most corporations. So I think it is very difficult to use the State experience to make assumptions about what will happen on the Federal level.

Moreover, we have read a lot about the State experience, and I think the evidence is quite mixed. Some of the programs have been quite successful. Some of them have been failures. That is why we think it is very important to come up with a narrowly targeted program, a limited number of zones, and carefully analyze those zones to determine whether they work, and if they do work, we will find out what elements are most successful and try and duplicate those particular provisions in other areas.

Senator Lieberman. I think this is where we have the disagreement, because as I look at the State record, the zones have worked, and they have worked without the Federal tax incentives or the Federal grants that are part of the administration's recommendation.

In fact, what we are doing, as I said briefly in my opening statement, is no different here than just taking a tried and true approach that has been used at the State level, leaving aside enterprise zones to attract businesses and just focusing it in on the poorest areas. I do not know what we can do to try to convince you that these things do work.

In fact, just to restate it, I think that the example at the State level is exactly what we are trying to expand and sweeten with the Federal tax incentives that are a part of this program.

Do you want to add anything?

Mr. Cuomo. Mr. Chairman, when we focused just on the 10 empowerment zones, I do not think it is right to dismiss the 100 enterprise communities that do not have as many incentives as the 10 zones, but that pose an attractive package not just on the tax incentive side, as the traditional enterprise zone benefits would suggest, but also, what we have for the 100 communities is the ability to now combine what are now separate categorical Federal programs.

What this would do is, if the locality came up with a comprehensive, strategic-based plan, the enterprise board which would be established in this legislation could allow that locality to combine what are now separate Federal programs. You could then take HUD programs and more easily put them together with education programs or infrastructure programs, so it would make what is

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now existing money, in essence more valuable by allowing greater flexibility.

Senator LIEBERMAN. Let me go on to another part of this to explain why I am concerned about the proposal as it is, Mr. Cuomo.

You mentioned that in the grant part of this administration program there is up to $30 million per zone per year, which is a substantial amount, $150 million over the 4 years or 5 years, but I wanted to focus on the tax incentive side of it, because as I understand it, most of the tax incentives are limited to the 10 enterprise zones.

As we look at it, it appears that about 80 percent of the $4.1 billion will go to the wage credits and the targeted job tax credit, so that you are going to have about $3.2 billion over the next 5 years going to these 10 zones in tax incentives, which is about $320 million a zone, which is an enormous amount of money per zone, when the need is so diverse as we have indicated.

Like we have said before, over 300 communities probably qualify for this, and I do not know that the businesses that are typically going to move into the zones will have the kind of tax liability to take advantage of these credits.

I mean, it is unlikely these are going to be IBM and General MOTORS. These are going to be small start-up businesses, and they are not going to have the tax liability that could use all those wage and job credits that you are creating, so it is another reason why I think we are oversaturating in these 10 zones.

Mr. FOLEY. Senator Lieberman, I think that our program is designed to attract both small and large businesses, both expansions of existing businesses and new start-up businesses.

We focused on a wage credit because that is a tax incentive that is not easily abused, and in exchange for the tax subsidy we have some guarantee that somebody in the community is going to get a job.

We basically have two labor incentives in our package. We have a 25 percent credit that is based on the first $20,000 of wages, which would allow a maximum credit of $5,000. We put a lot of money into that credit, because we think it is something that can have a dramatic impact on employing individuals who reside in empowerment zones.

It is not just your basic wage credit. We allow the wage credit to apply to training expenses and educational expenses. We recognize that many of the individuals in these labor forces do not have the kinds of skills and educational levels necessary to hold some of these jobs.

So I think we have a very forward-looking proposal. We not only have a labor incentive for businesses located inside the zone, but we also have an incentive for businesses located outside the zone to hire enterprise zone residents.

We have expanded the targeted job tax credits, which will provide a maximum credit of approximately $2,400, 40 percent of the first $6,000 of wages. That provides an incentive for businesses outside the zone to hire zone residents, because one of our primary goals is to increase the employment level in these areas.

I think that we have a fair balance of labor and capital incentives. I note that is something that you are very concerned about, but I think we adequately address those concerns.

We have an increase in the section 179 expensing which currently just applies to equipment. We have expanded the $10,000 limit to $75,000, and we have added buildings to the list of items that the 179 expensing can apply to. So it is very clear that this is a program that will not only increase business's investment in equipment but will also provide an incentive to build and rehabilitate commercial buildings.

We have an incentive for residential development, too, in that we have expanded the low-income housing credit. We have got tax-exempt bonds which will provide low-cost financing for the construction of buildings and equipment, and we also have a capital gains provision which is part of our basic package which will also be available to enterprise zone businesses.

I think that is a balanced package. That is a package that will not only encourage employment but will encourage the construction and rehabilitation of commercial and residential buildings and will cause capital to flow into these areas.

Senator LIEBERMAN. Unfortunately, through no fault of yours the capital gains provision is no longer a part of the program based upon what the Democrats in the Finance Committee decided, although I hope we can put it back in.

I am going to yield, in light of the time, to my two colleagues. I would like to urge you to go back and take a look at the richness of the benefits and incentives put into those 10 zones, because practically I would love to see big businesses go into the zones. I think they are not going to.

We all say that small business is the engine of job creation. It is. Probably half the small businesses, the last time I looked at it, do not even have any tax liability. Among those that do, particularly the ones that are moving into enterprise zones are probably not going to be able to use very much of that $5,000 per-employee credit. That is pretty rich.

Mr. FOLEY. Senator, we agree that tax incentives are not going to be a very important incentive to a business that does not have any tax liability.

We believe that there are other ways to encourage those businesses to succeed and to provide incentives to those businesses. That is why we are working on a community development bank proposal which will provide technical assistance and financing to these smaller businesses that are just getting off the ground and may not have tax liability.

Senator LIEBERMAN. Understood, but again, and this goes for the capital gains proposal as well, the general one, obviously here we are talking about what incentives can we target so that we are going to—to use your word, Mr. Cuomo, seduce businesses to make a decision to move in and create jobs in areas where they normally would not do it because it is less secure, because it is less hospitable, but we are trying to tip the balance so that they will make that decision.

I hope Senator Mack will ask some questions about capital cost incentives, so I will hold mine on that and yield to him.

Senator MACK. Thank you, Mr. Chairman. I probably will not ask the questions that you were going to ask, but I know we will have ways of getting to that in the future.

I want to start in looking for a positive note, I think the fact that we are here discussing in essence what level of enterprise zones there should be in the country, at least we have come that far. At least it is a concept now that is being discussed by both Democrats and Republicans conservatives and liberals, and I think that is a very positive sign.

I am, to say the least, really disappointed though, that given President Clinton's comments with respect to enterprise zones, that there is not a more aggressive plan. I am going to make an assumption here that a lot of those limitations that we are talking about in fact are driven by what you perceive to be budget limitations.

But I would just go back to Charlie Rangel's comments a minute ago. As you all were in the room it was a very moving description of the kinds of experiences that take place on a day-to-day basis in the inner cities of our country and that I think require dramatic and drastic action.

So I would ask you not only to accept the perspective that he shared with us with respect to those problems, but the other side of what he said. We have a tendency to get into these discussions from a budgetary standpoint of the old static model, as if we were going to make these commitments to get the inner cities to the point where they are encouraging investment, business formation, job creation, as if there were no positive benefit to that.

Maybe that is something you all have taken into consideration, and it is not a large number and so therefore you have not been able to come up with a larger number.

I am going to take the position today that we are all headed in the same direction and that we want to find a common way to work together. But I am convinced that if you do not have more incentive in there for capital formation—and one of the messages in Florida, whether that is in Liberty City, Overtown, Melbourne, or Dunbar, capital is to the economy what oxygen is to the body.

I happen to agree with Senator Lieberman and with the points that you all have made that we have to have other parts besides capital, and we have to have other incentives besides the labor incentives. We do have to do things about education and training. I agree with that.

But if we put money into those areas without finding a way to take the dam away and allow capital to begin to flow into the inner cities, all of what we do will be a waste, and I see ourselves in this discussion making a choice.

Do we continue to provide the old subsidies that really means we are going to have to continue to provide those longer and longer, or are we going to put into place the tools of capitalism, which in my opinion is the reduction in the capital gains rate, to get that capital to flow in? I just do not think you have put enough emphasis in that area, and I would be interested in your responses.

Mr. CUOMO. Senator, I do not think there is a disagreement in principle or in purpose. The intent of this program is precisely what you pointed out, which is that the people who live in the zone

now who have experienced severe distress for decades, many of them would become independent. Get economic opportunity and get jobs in—allow people to become independent.

As Mr. Foley stated, we believe the package of tax incentives, capital and labor, will help entice businesses into the area as long as they are part of a comprehensive redevelopment plan for that area.

You quoted Congressman Rangel quite appropriately. As he said a few minutes ago, we should make certain that it works. The question then is, with the resources that are on the table, Senator, how do we make certain that it works?

Mr. Foley spoke to the incentives, and I point out again, as Senator Lieberman was discussing, there is about $30 million on the spending side per year, which we think is a reasonable figure for the comprehensive redevelopment package. We do not believe it is excessive.

If the decision was to reduce the resources that are in the 10 over the 100, we think you would run the danger of not performing any meaningful function in the 10. As someone said, everyone gets $1.98 and no one really gets anything. It does not amount to anything.

Senator Mack. Let me ask you this question, though—and I want to go to the Senate plan, because here is my fear, and I suspect it is yours as well. If we come up with a plan that is inadequate, and the "demonstration" does not work, those who are not supportive of this concept are going to say, see, there, I told you it did not work.

So the question is this. Given that the Senate did not provide for the capital incentives, do you believe that if the conference committee came up with an enterprise zone concept that did not include the capital gains reductions, do you think that the enterprise zone concept could work?

Mr. Cuomo. I think the enterprise zone concept cannot work. I think it works when the tax incentives are married with the comprehensive redevelopment plan. I do not believe either succeeds without the other.

Senator Mack. I am not arguing that. My concern is, at least as I understand it, the bill that has come out of the Finance Committee does not provide the capital gains incentives.

Senator Lieberman. It does not include any of the empowerment zone package at all. It totally excludes the tax side of it.

Senator Mack. My concern is without the tax incentives I do not know what we get.

Mr. Foley. Senator Mack, I would just like to emphasize the point that there is a reduction in the capital gains tax rate that has been proposed by the administration.

Senator Mack. I understand, but I am focusing in on the issue on the Senate side. What I am asking you is, if we ended up with a compromise in the conference committee that did not include the tax incentives, what have we got?

Mr. Foley. A compromise that does not include any tax incentives?

Senator Lieberman. As I understand it, the Democrats on the Finance Committee have agreed to a package that totally excludes

the $4.1 billion in tax incentives for the enterprise empowerment zones that the administration recommended, and that was included in the House side.

Mr. FOLEY. I am not going to speculate on what is going to come out of conference. I think it is obvious that——

Senator MACK. I am not asking you to speculate. All I am trying to do is get to the point that if you do not have the tax incentives and somehow or another, as happens in politics, the idea is sold that we are going to move forward with enterprise zones and empowerment zones, and it does not have the tax incentives in it, then I think it fails, and then those people who wanted all along to defeat what we are trying to accomplish say, see, I told you so.

Mr. FOLEY. Senator Mack, our proposal consists of both tax incentives and spending initiatives, and I think that it is going to take both of those to have a successful program.

I do not think that a larger capital gains exclusion is going to make that much of a difference. The administration's proposal has a 50 percent exclusion for capital gains if the stock is held for more than 5 years. Going back in history we have not had a 14 percent capital gains rate since the 1930s.

Senator MACK. I would make the argument that we ought to go further than that, but that is not my area of disagreement.

Mr. Cuomo, do you want to make any comment with respect to this?

Mr. CUOMO. I think what we are saying, Senator, is neither works without the other. If you had a package that came out without tax incentives, that is not the program we have laid out, and that is not the program we envision.

However, at this point the game is not over until it is over, and we will see what happens in conference.

Senator MACK. OK.

Senator LIEBERMAN. Senator Pressler.

Senator PRESSLER. Well, I have just one question, and that is, I am told that the Indian reservations in South Dakota do not qualify to apply one of these zones may be on an Indian reservation. My home State contains the first, second, and tenth poorest counties in the Nation. We have the Pine Ridge Indian Reservation, and so forth.

I would like to know how—and I am told none of those reservations qualify, or would fall outside the loopholes—how can we get on an equal footing to apply, or get one of these?

Mr. FOLEY. Have they indicated why they believe that they would not qualify?

Senator PRESSLER. They have indicated that in some way, the way it is written, that they do not qualify. I do not quite know what it is.

Mr. FOLEY. We would be happy to work with them and find out exactly what the problem is.

Senator PRESSLER. There is a technical problem or something, I do not know what it is, the way the thing is written, but would you have your people take a look at their qualifications, and their statistics.

Mr. FOLEY. Sure. If they could get in contact with us, with the particular characteristics of their area, we would definitely analyze it.

Senator PRESSLER. The characteristics are well-known. If you could submit a statement to the record as to your assessment of them, and we can give you all of the statistics and so forth—would you be willing to do that?

Mr. FOLEY. Well, in our testimony, we clearly set forth the property criteria and geographic limitations, and I think it is pretty clear in our testimony what the limitations are. What we really need to know is information from the area to determine whether they meet our criteria.

Senator LIEBERMAN. Let me just close and thank both of you, and I hope we can continue to work on this.

Again, I want to say, as I guess we have all said, it is great that we are arguing about the details, and in a sense not the dollars here. The administration is prepared to make a substantial commitment, but I would hate to see it be a commitment that is limited in the number of communities it can help and does not deal with the fundamental problem of getting capital in.

We all talk about finding a third way and breaking through the old liberal-conservative Democratic-Republican ideological barriers. This is one of those issues that does it.

An example of it, when you were talking about capitalism, I was thinking of something that Reverend Jesse Jackson once said, and maybe that shows some of the range here, which is that if you take the capital out of capitalism, all you are left with is an ism, and that is not much. That is why I think particularly in these poor areas where people have such a tough time, when they have a good idea to start a business, to get capital, I do want to state that we ought to take a look at helping them do that.

I do want to just clarify that on the grant side of this proposal, I leave it to you to make the judgment about whether you have spread the money enough, but what I am really focusing on is the tax incentive side of it, the $4.1 billion tax incentive side and 80 percent of it going to 10 cities and 80 percent of that in wage credits.

That is a lot of money to those 10 cities, and I am not so sure they are going to be able to use it well, and therefore I think it is not only going to limit the range of the experiment, if it is that, but it is going to bias the results. In a sense, that is not going to work as well as it should.

I look forward to working with you on this. I thank you for your time and wish you good luck in the Finance Committee.

It is now our great pleasure—what is it the Speaker says?—the personal pleasure and high honor to welcome back to this Committee former Secretary of the Department of Housing and Urban Development, former Member of Congress, now the Chair of Empower America, Jack Kemp.

Thank you for being here. I think insofar as enterprise zones are concerned there will probably never be a paternity action. You are clearly one of the fathers.

[Laughter.]

Senator LIEBERMAN. In that capacity, we welcome you.

STATEMENT OF JACK KEMP, FORMER SECRETARY, U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Mr. KEMP. Thank you. That may be part of the problem, that my name got associated with it so early that the debate has unfortunately turned too political.

I would like my remarks submitted for the record, Mr. Chairman.

Senator LIEBERMAN. They will be, and thank you very much for changing your schedule to stay here. We ran a little longer with Congressman Rangel.

Mr. KEMP. I tell you what, if this had been held a year ago today, or a year ago last month, this place would not have been big enough to hold the press that would have been here to find out what was the response of the Bush administration to the crisis in Los Angeles and in urban America, and I feel disappointed that there is not anybody, with all due respect to the men and women who are here——

It is a sad testimony that it has been a year and the tears that were shed of crocodile variety over the lack of an urban policy by the previous administration today has waned to a point where the press is perhaps uninterested in L.A. 1 year later.

I wish they had heard the testimony of Charlie Rangel. It was moving, as you pointed out, Mr. Chairman, it was perceptive, it came from the gut and the heart as well as the head and the intellect. I applaud you.

I appreciate the comments that have been made by this panel. I am disappointed more people are not here on this side and more people are not there on your side—I mean, on both sides of this issue, although important things are going on, so I am not being disrespectful.

I just want to make a quick quote of something that someone said all too recently. It seems to me, he said, that the enterprise zone proposal of this administration is too little in the sense that it has only 10 genuine enterprise zones, that it is too much in that it pours too much money into those 10 enterprise zones, and it is too light on capital cost incentives, which are critically necessary to leveraging public investment by attracting more private capital into our inner cities and poorer rural communities. Its problems are based on a misunderstanding that the enterprise zone concept still needs testing.

Then this individual of great leadership potential for this country said, I know it has been widely and amply tested over the last 11 years throughout many States and cities in America and has passed the test with flying colors.

Now, that was not Dick Cowden of the American Enterprise Zone Association, that was not Paul Pryde who is behind me and is going to testify later, it was not Stewart Butler of the Heritage Foundation, and it was not Jack Kemp, Connie Mack, or Larry Pressler.

That was the Honorable Joseph Lieberman, the Senator from Connecticut, for whom I have high regard and high praise for taking this issue to a higher level, and I just want to thank you, Joe, if I can say it that way, not only for what you and Bob Kasten

did in the last Congress, but what you and Connie Mack and Larry Pressler and others are trying to do in this Congress.

One other comment before—and I am like the Rabbi who said, before I speak, may I say a few words?

[Laughter.]

Mr. KEMP. Before I deliver my testimony, may I say a few words?

You quoted Jesse Jackson. Did you know that it was Jesse Jackson at the 20th Anniversary of Black Enterprise Magazine, published by Earl Graves, a mutual friend of ours, in which Jesse Jackson got up and suggested that capitalism without capital is nothing but an ism, it is an abstraction. Everybody laughed at the statement, but then as I began to think about it, I have quoted it all over the country.

It is ironic to me that the zeitgeist for the whole world is Democratic capitalism, but here is a democratic administration that is embarrassed about incentives to expand capital. There is no other way to say it.

I feel a little bit like Robert J. Samuelson, who said last week that—I will not say exactly what he said, but he said he would like to be more diplomatic in his criticism of the administration, but that would be missing the point.

I do not want to miss the point here. I want to be very blunt. I will be accused of being partisan. You will probably be accused for inviting me here. I have no axe to grind. It is not my idea. I stole it from someone else who stole it from someone else who stole it from someone else.

There are no new ideas on the face of this earth. They are all a product of the wisdom of the ages. This idea goes back to Joseph in Egypt, when he told the Pharaoh that if you wanted to create 7 fat years they would have to cut the tax on the production of grain from 90 bushels out of 100 bushels that went to the Pharaoh down to 20 on the radical theory that people would respond to rewards.

That is all this is. We do not need to debate whether or not this is going to work. You either believe people respond to rewards or you do not. You either believe that democratic entrepreneurial capitalism will work in Watts or East L.A. or East St. Louis or East Harlem, or in Hartford, or in Newark, or Liberty City, or on an Indian reservation in South Dakota, or you do not.

You either believe that human beings respond to the rewards that they believe will improve their lot in life, or you do not, and if you do not—you cannot debate with anybody that does not have that view.

Sitting over here listening to Charlie Rangel almost moved me to tears. What do you tell a person who says my only pleasure in life even if it is existential, even if it leads to destruction, jail, the morgue, or worse—is to sniff or snort or smoke or light up or whatever it is that the current language uses as a euphemism for taking drugs?

I have been accused of being an economic determinist. I guess I have given that impression, but I really believe with all my heart there are too many young people in America turning to the streets who could be turned back to education, turned back into productive resources for themselves, their families, and their country, if there were incentives predicated upon the wisdom of the ages. Adam

Smith said the desire to improve one's lot in life does not come from the State, it comes to us out of the womb of our mothers, and never leaves until the day we die. I believe that with all my heart.

I do not come out of anger to this Committee. I come out of a sense of frustration, a sense of agony, a sense of tragedy, a sense of disappointment that here it is a year later and nothing has been done. This bill, Mr. Chairman, was introduced in the late 1970s.

This was introduced as a memorial to the late, great Democratic Governor of the Island of Puerto Rico, Luis Munoz Marin, under whose leadership with Franklin Roosevelt led to the development of the Island of Puerto Rico, and they called it Operation Bootstrap.

When Bob Garcia, Bill Gray, Charlie Rangel, and Jack Kemp were memorializing Luis Munoz Marin, the Governor of Puerto Rico, I remember saying something to the effect, why do we not try an Operation Bootstrap in Buffalo, Harlem, North Philly, and South Bronx?

That was the inception of it, and so I today totally give the credit to Luis Munoz Marin, who should have given it to Abraham Lincoln, who should have given it to Alexander Hamilton, who should have given it to Adam Smith, who should have given it to Joseph in the Book of Genesis.

Senator LIEBERMAN. My rabbi thanks you.

[Laughter.]

Mr. KEMP. Well, you are my rabbi.

Senator LIEBERMAN. And you are mine.

[Laughter.]

Mr. KEMP. A year ago last month I wrote an article on the op ed page of The Washington Post and suggested that after I called Tom Bradley, the mayor of Los Angeles, to ask him what I could do to help, what the Bush administration could to help, what HUD could do to help Los Angeles and other urban areas, he said now maybe we will get the enterprise zone bill passed.

That is all he said—now maybe we will get the enterprise zone bill, and I put it in my lead of the op ed article, and I will tell you why, Mr. Chairman.

When I went out to LA with the President we sat down with the mayors of Inglewood, Compton—who is now a Congressman from Los Angeles—Los Angles and North Long Beach—we met with seven mayors. Five were black, two were Anglo, six were Democrat, one Republican, and every single man and woman, mayor and/or staff in that room begged the President to tell the Democrats and the Republicans in the Congress to put aside their partisanship and on an emergency basis please pass an enterprise zone bill, not just for East L.A. but for South Central L.A., and not just for South Central L.A. but North Long Beach, and Northeast Inglewood.

And that is why we came back to the conclusion, as was found in the first Kasten-Lieberman, better known in Connecticut as the Lieberman-Kasten bill——

[Laughter.]

Mr. KEMP (continuing). That any area of the country, as Larry Pressler pointed out, be it in rural or urban America, and which had high levels of unemployment, a shrinking tax base, high levels

of human tragedy, pain, welfare cases, and a shrinking population as well as a shrinking tax base would qualify for two or three things. The essential ingredients of the zone approach, as you put it in your very fine speech on the floor of the Senate, Mr. Chairman, zero tax on any gain from an asset invested in a zone that had once been redlined, was now, in Stewart Butler of Heritage Foundation's words, to be greenlined. None. Zero.

No alternative minimum tax, no capital gains tax on any man or woman who took his or her capital and put it at risk and created an enterprise on the radical theory that you and Paul Tsongas have championed in your own party that you cannot create employees without also or first creating employers, that you cannot have a lot of jobs unless you have a lot of entrepreneurs.

I want to disassociate myself with the remarks of this HUD administration. Apparently Mr. Andrew Cuomo who testified on behalf of HUD Secretary Cisneros—I wish he had been here himself. I testified 150 times on enterprise zones.

I think it would have shown a little bit more of the passion of this administration about urban American to bring Ron Brown up here, who is responsible for L.A., and bring Henry Cisneros up here and show that they truly care—I know they care, but how can you really care and suggest that we are going to try this as a demonstration?

Do we have to demonstrate what the whole world is discovering from the Pearl River Delta of China—they have more enterprise zones in China than we have been able to have through the Federal Government's support in the United States of America. Deng Xiao Ping is a greater running dog capitalist pig than any one of us.

Did you know that Deng Xiao Ping said to the China press recently that it is socially desirable for people to get rich in China? I have the feeling in this country that we want all rich people to line up against the wall and we will shoot them at dawn. That is what the Jacobins suggested in the French Revolution. They were going to shoot all rich people.

What is wrong with getting rich? Abraham Lincoln said, I do not want laws that prevent someone from getting rich. I want everybody to get rich. To be rich is not rich in creature comforts as much as it is rich in opportunity, and how can you get more opportunity to the center city without ending the redlining?

I do not need to define it for you, but redlining for those who may be listening or watching is clearly the prevention of capital and credit going into certain neighborhoods and certain communities predicated upon demographics. That is why an Indian reservation in South Dakota or an inner city in Connecticut, or Overtown or Liberty City in Florida or South Central L.A. would immediately qualify under the Lieberman-Mack-Pressler conceptual framework of this debate.

Number 2, there are no capital-based incentives, Mr. Chairman. You cannot have entrepreneurial capitalism without incentives to form capital, and the purpose of the bill, as Andrew Cuomo said and with which I wanted to disagree, is not to lure businesses from the San Fernando Valley of Los Angeles into the center city, it is to try to create enough capital so that minority men and women in

South Central L.A. or in East L.A. or in East Harlem or in areas of Connecticut that have enterprise zones—but you are just tinkering actually with the sales tax, as I understand it, or depreciation schedules for business.

It is to form new businesses. It is not to lure Detroit to move to L.A. as much as it is to encourage entrepreneurial-minded men and women, black, Hispanic, Latino, Asian, Korean, or Anglo to get access to credit and capital to start their own business.

Poppa Kemp started his business with capital. Every business in America has started with capital. John Johnson started Ebony Magazine with capital. He sold furniture to get $400 to start Negro Digest in 1946, and today I bet you it would be very difficult to emulate what John Johnson has done to become the richest African American in the United States of America, according to Forbes Magazine.

We are shutting off the next generation of entrepreneurs because we are waging war on the formation of capital, and we are not hurting the rich, we are hurting the poor who want to get rich. We are not hurting the wealthy, we are hurting the creation of wealth.

We are not hurting the existing businesses of the Fortune 500 that do not create new jobs, we are hurting the creation of those businesses that probably, according to David Birch at MIT, generate about 90 percent of all the new jobs in America, businesses with less than 150 employees, and this war against capital formation is absolutely going to turn against us. It certainly turns against the zeitgeist of the world, and it is embarrassing to suggest that we are going to have 10 empowerment zones.

Now, let me say I do not care if they call it enterprise zones, opportunity zones, development zones, empowerment zones, or Connie Mack zones. I do not care what the name is. Put aside politics or names, but they ought to do something. Call them entrepreneurial zones or something, but get it out of the realm of Kemp and Lieberman and put it into the realm of that third synthesis that you talked about between these two antitheses that cannot seem to get going. This inertia is killing it.

The third point that needs to be made, other than the fact that there is no capital-based incentives and there are not enough of them, the third is that you could spend your way to development. Everybody here said tax incentives are not enough. Okay, I agree. We spent $3.5 trillion since 1964 attempting to spend our way out of poverty, and poverty is winning the war.

I am not against spending, and I get hit for that from my right flank. So be it. I am not against spending if it actually empowers people, not bureaucrats. But to set up a zone czar or to set up a board that is going to determine the allocation of credit and capital, pick winners and losers, is nonsense. John Johnson would never have been a winner. They would have picked the bigger guy, the one with the political influence.

How about Sam Walton, who was a failed haberdasher? Do you think he would have gotten access to credit and capital? Uh-uh. He had to do it by going out and raising his own capital. Bill Gates dropped out of Harvard. Would he have gotten access to capital? No way. Government would not give it to him. They would give it

to General Motors or Lockheed or Chrysler, because they have a lot of lawyers and a lot of accountants.

But you see, whenever you allocate credit and capital, the little guy, the little gal, the mom and pop, the entrepreneur gets shut out. We do not need a zone board, we do not need a zone czar, we need to let the marketplace work, and the only way the marketplace will work will be to absolutely remove any tax on the entrepreneur who adds his or her assets, or puts those assets to work in the inner city and creates jobs.

There ought to be a much stronger incentive for the worker. The only incentives for this are wage-based incentives for the employer, which are mature industry. No incentives for an entrepreneur. They ought to lower the cost of labor by suggesting that the earned income tax credit, or refundable earned income tax credit as in Kasten-Lieberman, be raised to a point where a welfare mother who takes a job and an unemployed father who wants to go to work faces no payroll tax or income tax up to about 190 percent of the poverty level.

Finally, and I will stop on this, the Rangel amendment to form venture capital for minority enterprises, every single minority man and woman who has ever testified before this Committee, Mr. Chairman, at one point in his or her testimony will tell you their biggest problem is seed corn. The biggest problem is getting start-up capital. The biggest problem is getting access to the credit markets and capital markets.

So Charlie Rangel came up with a beautiful idea. Allow someone to expense their investment in the debenture, the equity or the stock of an enterprise that forms in the inner city's greenlined area, or on an Indian reservation.

I wanted to do it originally up to $250,000. It got reduced to about $50,000 by the OMB of the past administration. Isn't it ironic that now we are not even debating raising venture capital, and they call it trickle down. Nonsense, trickle-down economics. How dare people call it trickle-down economics? Niagara Falls would be more like it. Niagara Falls. You would be awash with capital.

In fact, if you eliminated the capital gains tax and expense venture capital investments in equity and debenture of inner city minority enterprises, I guarantee you would have to do something about the rest of the economy, because it would be so attractive. It would be so attractive to move into East Harlem or L.A., despite the problems of those areas, and I think there is tremendous talent there, by the way. Tremendous talent, but the incentives are upside down.

You are going to have to do something about the Bradley amendment to place a surtax on the capital gains tax. You are going to have to do something about taking off indexing from the top income tax brackets, this war on success, this war on entrepreneurship, this war on capitalism in this country, this class warfare attitude of all too many of our colleagues in the Congress and too many members of the Council of Economic Advisors and by the current Labor Secretary who is a very, very fine man so I promise I am not attacking him ad hominem, but he has to defend his statement.

He said the age of the entrepreneur is over. We need collective entrepreneurship, which is one of the great oxymorons of all time, ranking up there with military intelligence.

[Laughter.]

Mr. KEMP. Mr. Chairman, I do not know what to do about this. It has been a year and 2 months. Nothing has happened. They have zeroed it—budget mania, budget phobia, deficit mania, hypochondria.

It is not the deficit that is causing the recession in the inner city of America, it is the recession that is causing the deficit. You cannot balance a budget absent getting this country back to work, and you cannot get the country back to work and not rely on the men and women who put people back to work, and those are the people with the propensity to save, invest, and take an entrepreneurial risk, and we are removing from the greatest democratic capitalist system in the world the reward for risk-taking.

You cannot rely on the Fortune 500 companies to put this country back to work. It will not work. They do not create jobs. You have got to rely on entrepreneurs.

Your interest in this issue is unparalleled, and to my friends Connie and Larry, I just want to thank you for giving any attention you can. I do not know how you are going to do it, but I will tell you, somebody has got to speak out for the poor. Somebody has got to speak out on behalf of capitalism. Somebody has to speak out about putting capital back into capital, and somebody has got to speak out on behalf of incentives and rewards and how to fight poverty.

If you have to spend a little money to make Charlie Rangel a cosponsor—and I say that with a smile on my lips. He is one of my very best friends. The Black Caucus and the Conservative Opportunity Society Caucus coming together on enterprise zones could be one of the great coalitions of all time.

But I hope there are some people with the courage enough to do it. Charlie has got the courage. I hope some of us on the right can find a way to put this new coalition together on behalf of urban America and rural America, those areas of the country that are really hurting and starved for oxygen. There is no oxygen. They are dying.

[The prepared statement of Mr. Kemp follows:]

PREPARED STATEMENT OF HON. JACK KEMP

Mr. Chairman and Members of the Subcommittee, I appreciate the opportunity to testify before you today on the subject of enterprise zones. I would also like to express my personal appreciation to you, Mr. Chairman, and to Senator Mack, for your leadership on this issue.

As you know, Mr. Chairman, I have always shared your belief that reviving our Nation's distressed communities is a vital national priority that must extend beyond party lines. Action on this front is long, long overdue. I'm sure that Congressman Rangel, a leader on enterprise zones in the House for well over a decade, delivered the same message in his testimony earlier today.

I must admit, I had hoped to appear before your committee under different circumstances. I had hoped that President Clinton would fulfill the promises he made during the presidential campaign and in his book, Putting People First, to present Congress with strong enterprise zone legislation. I had hoped to be able to support a bipartisan initiative to restore economic growth, jobs, and opportunity for people living in our Nation's struggling inner city communities.

Sadly, this is not the case.

The Clinton Administration's empowerment zone proposal is a weak imitation of the enterprise zone concept which falls far short of what is needed to revitalize America's urban and rural pockets of poverty. In my view, the Clinton program reveals an administration with the most anti-capitalist mentality in this century, maybe even in our Nation's history. This is not the work of a "new Democrat." It is a throwback to the top-down, paternalistic policies which have dominated liberals' thinking on poverty since the Great Society.

Even this ineffective proposal was zeroed out entirely by the Senate Finance Committee in its markup of the President's budget. It is inconceivable to me how we can expect to solve the problem of the deficit without dramatic incentives to restore economic growth, jobs, and entrepreneurship to our inner cities.

For over a decade now I have testified again and again in favor of enterprise zones in both the House and Senate. I know you shared my high hopes, Mr. Chairman, that last year's Los Angeles riots would finally provide the impetus for a bipartisan enterprise zone bill. And I know you share my disappointment that it did not. Based on the Clinton Administration's proposal, we can expect little improvement by the time we mark the second anniversary of the L.A. riots.

The key idea behind the original enterprise zone proposal was that tax and regulatory incentives could spur the creation of new jobs and new businesses. Entrepreneurs, investors, and small business men and women would be rewarded for creating jobs in America's impoverished communities. Just as importantly, inner city residents would gain a stake in their neighborhoods by becoming owners of property and businesses.

The Clinton plan illustrates a clear misunderstanding of the principles upon which the original enterprise zone concept was based. In my view, the major problems with the Clinton proposal include the following:

First, under the Clinton proposal, only 10 zones would be eligible for federal tax incentives with only 6 in America's inner cities. Another 100 "empowerment communities" would receive no incentives, but would be eligible for targeted federal spending—a cruel hoax designed to inflate the appearance of the administration's weak proposal.

Mr. Chairman, this is a far cry from the original enterprise zone legislation you sponsored last year along with Senator Bob Kasten—a bold plan which would have created 300 zones covering nearly every community suffering from endemic poverty, unemployment, and welfare dependency. I was proud to support that bill as Secretary of Housing and Urban Development, and I'm anxious to do whatever I can now to help advance a meaningful enterprise zone proposal in Congress and the administration.

While the Federal Government has been bogged down over enterprise zones for the past thirteen years, 36 states and the District of Columbia have taken leadership on their own by establishing local enterprise zones. According to a recent article in Nations Business, over 663,000 jobs have been created within these zones and nearly $4.1 billion has been invested in distressed communities.

We do not need an experimental enterprise zone program. We do not need to prove that entrepreneurial capitalism and private property ownership work. What we need is a bold, aggressive commitment to an idea which has proven to be effective in generating growth, jobs, and investment in America's poorest communities.

Second, the tax incentives in the Clinton proposal are weak, misguided, and misdirected. Nearly all the federal tax incentives are in the form of wage credits and an expanded Targeted Jobs Tax Credit which would be paid to employers. These incentives would benefit only existing businesses; there are practically no incentives to encourage the creation of new businesses.

Granted, the wage credit, expensing and depreciation provisions in the administration's plan are necessary for a cohesive enterprise zone plan. But, more wage credits will not reduce unemployment because it will give businesses little incentive to hire additional workers. Moreover, without capital-based incentives for entrepreneurs, small business owners, and investors, the plan will fail to address the most pressing need in America's inner cities—the need for permanent, new private sector jobs.

Today, the greatest obstacle facing the poor inner cities and rural communities is the federal government. High taxes on capital formation and heavy government regulation are draining any hope for investment, entrepreneurship, and job creation out of America's inner cities. Not only does the Clinton empowerment zone plan fail to reduce the tax rate on risk-taking and entrepreneurship, his budget plan, as passed by the Senate Finance Committee, actually raises the top tax rate on capital gains to almost 31 percent.

President Clinton does not understand the fundamental principle that to create more employees, we first need to create more employers. What inner city entrepreneurs and small businesses need most is access to seed capital to start a new business or expand an existing one. The major problem facing poor inner cities and rural areas is the deficit of capital.

Eliminating the capital gains tax would dramatically expand entrepreneurship and job creation in our Nation's most distressed communities. Existing incentives in Clinton's plan are useful if you already own a business with a significant payroll, but the capital gains tax, primarily a penalty on risk-taking, is the major obstacle facing the creation of new businesses.

When the top capital gains tax rate was reduced in 1981 from 49 percent under previous law to 20 percent, the number of small business company startups more than doubled, rising to 640,000 from 270,000, creating 15 million new jobs. By eliminating the capital gains tax in distressed areas, we can put that enormous job-creating potential to work where it is needed most.

Another important incentive missing from the Clinton proposal is the expensing of investor purchases of newly issued stock in small businesses located in a zone. Because start up businesses typically have little or no tax liability in their first years of operation, there is a limit to what direct tax reductions can do to help these firms. By giving investors in these new businesses an up-front deduction of new equity investment, inner city and rural entrepreneurs will receive the kind of seed capital they need to turn their entrepreneurial ideas into a successful, working business.

Third, the Clinton plan abandons the entrepreneurial spirit which characterized earlier enterprise zone proposals. Under the administration's proposal, the zones would be micro managed by a Washington-based federal "Enterprise Board." Washington bureaucrats, not local entrepreneurs and investors would determine which economic development strategies to pursue.

Enterprise zones were intended to free inner city entrepreneurs and investors from the bureaucratic welfare state which controls nearly every aspect of the lives of low-income people in America's distressed communities. The Clinton approach would only put more power into the hands of Washington bureaucrats.

My regretful conclusion is that the Clinton "enterprise zone" proposal should be scrapped altogether in favor of a real enterprise zone program, such as the one advanced last year as the Lieberman-Kasten proposal. The essential ingredients of this approach include:

A dramatic expansion of the number of zones. The $4.1 billion that the administration is spending on their paltry empowerment zone proposal could produce at least 75 enterprise zones with the right kind of incentives, as the Chairman is proposing.

An elimination of the capital gains tax on anyone who works, saves, or invests in the zones. This would dramatically increase the seed capital flowing into America's low-income communities and reward entrepreneurs and small business owners—the engine of new job creation.

Stock expensing to give investors a meaningful incentive for investing in new zone businesses.

Limited federal interference through Enterprise Boards or Zone Czars. The key to revitalizing our inner cities is igniting the creativity and innovation of America's entrepreneurs and small business owners. Top-down federal government control of zone activity will not advance this goal.

It is time to stop testing and start acting. Enterprise zones have proven their worth in state after state, community after community. Zones with the proper incentives in place will produce a windfall of jobs, investment, and revenues for strapped city treasuries. Bill Clinton's "empowerment plan" is a step backward from the significant, although slow progress of the enterprise zone movement.

Stuart Butler of the Heritage Foundation, one of the intellectual founders of enterprise zones, wrote of the Clinton plan: "The White House package is, in fact, just another dose of Washington direct inner city industrial policy—of the kind that has hastened the decline of America's cities. The Clinton program actually is worse than nothing, because state officials will be induced to adopt the administration's misguided view of economic development as the price for questionable benefits ... America's inner cities would be far better off if Clinton's bizarre vision of enterprise zones never reached the statute book."

With your leadership, Mr. Chairman, and with the leadership of this committee, I hope that the Clinton Administration will go back to the drawing board and come

forward with a real enterprise zone proposal closer in spirit to what he promised in the presidential campaign.

Senator LIEBERMAN. Jack, thank you. It is great to have you back on the Hill. You obviously have not lost either your sense of direction or your sense of passion, and both are a real tonic for us.

There is no question that this has been such a long march, I thought we were within reach of it. Now we have got some money on the table, but a strange system.

Mr. KEMP. It will not work, Mr. Chairman. It will not work. They all say they want it to work, but they are designing it so it will not work, and that hurts. That hurts badly.

Senator LIEBERMAN. Before I say anything more, I think Senator Pressler wants to just make a statement, and then he has to leave.

Senator PRESSLER. I can make this brief. I am going to have to leave.

First of all, thank you very much. I just wanted to say that I represent the poorest county in the United States, which includes the Pine Ridge Indian Reservation, and that reservation has been a classic welfare state for 50 years at least, layer upon layer of bureaucracy. I could go into it, but for the purposes of brevity I will not, and it gets a lot of attention.

Recently, Robert Redford made a movie called "Incident at Oglala." I disagree with his conclusions completely, but the point is we have about a movie star a month coming out, holding a press conference. They usually attack the Reagan-Bush administration. I do not know what they are going to do now.

But in any event, I have worked with these people for a number of years, and they need nothing more than an enterprise zone, and there is a change that is starting to occur on the reservation, as I mentioned. When I met with the leaders this year, they put economic development through private enterprise near the top of their list of priorities.

During the debate in the Senate on the stimulus package I was the only member of our small delegation to oppose the package, and the Indian leaders were asked by the White House to do a press conference attacking me. They refused to do it, because they are getting tired of all this.

There are changes occurring. There are people being elected in tribal councils who want something different, and I have noted some of these elections in the urban areas. Things are changing, but we must respond to that.

When you were out of the room, I asked our friends from the administration, I do not believe that Pine Ridge qualifies under the rules that they have laid out. It has very little chance of getting this one zone, but in any event, I wanted to say that I salute you.

I look forward to taking you sometime to the Pine Ridge Reservation. You are a person I would be proud to stand there with, and there is something going on there in terms of what the leaders are asking for, in terms of the old political rhetoric. They are not willing to sign on so much any more, and I am very hopeful we are going to see some changes. As you said, I find all this very ironic, how this room is not full of press because this is the way to turn this around.

I have to go to another meeting. I thank the Chairman very much for holding this hearing. I commend our chairman for his leadership, and I thank you very much.

Mr. KEMP. Larry, at some point someone is going to raise the question about the cost, and in my view you ought to bring up Pine Ridge and ask them about the cost to keep people living on a condition of dependency and then say, and what is the cost of eliminating the tax on a business that has not yet formed on Pine Ridge Reservation? What is the cost?

None. Zero. If it does not work, it does not cost anything. If it works, you add to the tax base. Pine Ridge would be a perfect example. Guadalupe, Arizona, a perfect example of an area that could be greenlined, and what is the cost of eliminating the capital gains tax on any man or woman who has not yet formed a business? As soon as something takes place up here, activity begins and the tax base will begin to expand.

So I think we ought to turn this from a static analysis to a dynamic analysis and get off of this kick that you have to cut out enterprise zones in the Senate Finance Committee in order to make room for a deficit reduction package.

Every 1 percent drop in unemployment will drop the deficit by $70 billion. Where is the argument being made that the way to reduce the deficit is to bring down the cost of welfare, bring down the cost of unemployment insurance, bring down the cost of those social services that Charlie Rangel talked about that cost us as taxpayers to put a young male in prison? That is a huge cost to society.

Senator LIEBERMAN. Thank you. Senator Mack.

Senator MACK. Thank you, Joe. Again, I welcome my friend and appreciate your being here and eloquently speaking about the need for enterprise zones so we can change the dream of that little guy I talked about a few minutes ago that Eddie Taylor pointed out to me when I was in Melbourne.

As you were talking through, and maybe as Charlie was talking through the concerns about this legislation, one other thought occurred to me, and I may be wrong on this, but I think it was Hernando de Soto who wrote about, in essence, why things are not working in South America. Specifically stating that over the years through their legal system and their economic system, a whole series of hurdles were created to keep people out of business.

It came from a different approach than what happened, I guess, under the English system, but he mentioned something like if you went every day for something like 300-plus days it would take you that long just to get the paperwork to start a new business.

So what I was thinking about is that it seems to me, Jack, that we also ought to be talking about some kind of moratorium on the regulatory burden. We ought to be talking about some way to lift the regulations, even if it is only for 6-months or a year to start up the business, or coming up with some way to cut through this.

I know what triggered the thought, Jack, is when you made the comment about the $400 and the starting of Ebony Magazine, that it would not happen today, and it is not just because of the capital, it is also because of the regulations and hurdles that would have to be overcome.

I am going to have to leave as well, but a moment ago you said the plan that has been put forward will not work. Tell me why it will not work, and tell me what we need to do to make it work.

Mr. KEMP. Well, when I say it will not work, I was using that as a metaphor for what is wrong with it. I imagine, like a couple of areas of the country, you could induce someone to start a business in a public-private partnership if he or she got enough wage credits and enough spending around the neighborhood.

I guess you would be able to point to it, but it would not work in the sense of launching an entrepreneurial revolution, so I want to put it in that perspective, as I need to put my statement about military intelligence as an oxymoron into greater perspective.

Military men and women are very bright, and I was using a metaphor for some of the poor intelligence that we have gotten over the years, but, I do not want men and women in the military to think that I do not think they are intelligent. Sometimes my tongue gets engaged before the rest of me.

It will not work in the sense, Connie, that Joe Lieberman said it will not work, it apologizes for capitalism, it apologizes for incentives, and I think we made the point—Larry did, anyway—that an Indian reservation—and I am not saying anything against the Native American population, but the system into which they have been put is a socialist Third World welfare State that even they know is not working.

How else can you explain their desire, in the main, to open gambling casinos—that really is not productive, but it creates a little bit of wealth for some, and it is a tragedy today that gambling casinos are called economic development for cities and States and Native American reservations.

So it will not work in the sense of what works in Hong Kong, what works in the Pearl River Delta of China. How can you explain that in China three provinces produce 95 percent of all the economic growth in China?

The IMF the other day said that China is not the twelfth largest economy in the world, it is the third largest economy in the world, and it is because of the changes that have taken place in the last few years in three provinces, the leading of which is the Guong Dong Province which is the South China coastline off of Hong Kong, which listened to Hong Kong and looked at their model instead of the IMF.

Unfortunately, Russia has been forced into the hands of the IMF and Asia is following the Hong Kong model. I am trying to get the Hong Kong model to be used in the inner cities of America.

Incidentally, for the record, the top tax rate in Hong Kong is 16 percent on income, 17 percent on corporate income, zero on capital gains. All private property, no unemployment. The City Council of Hong Kong's biggest debate every year is in what to do with the surplus in the budget.

There is no public housing, it is all private housing or private ownership of housing, free banking, free trade. They have a trade surplus with the United States, and there are no barriers to the U.S. entry into the Hong Kong market, and we still have a deficit, which says something about the debate over Japan and Mexico and the North American free trade zone.

It will not work because it is embarrassingly mild on the incentive side. It will not work because the whole economy is going to be starved for capital with the new income tax rate increases. We are raising the income tax rate, according to Larry Cudlow, by 40 percent on men and women who make about $120,000 who have a propensity to save and invest, not consume. Obviously, they consume, but those are the people you expect to save and invest.

I am not arguing to protect the rich. I am arguing that the way to help the poor is to allow them to get rich, and you cannot get rich on wages, so by raising income taxes and by raising capital gains taxes and by locking people into a capital gains tax that is unindexed, we are drying up the source of new capital for the newer businesses that want to form and get going, and we are protecting the older businesses by giving them tax incentives through the new tax code.

The system will not work the way it is designed both at the macro level and the enterprise zone at the micro level, and I will say it, and I know I do not want to embarrass my friend Joe Lieberman, because he is a good card-carrying dialectical bleeding heart, Scoop Jackson Democrat——

Senator LIEBERMAN. You had me worried there for a minute.

[Laughter.]

Mr. KEMP. We are preventing people from getting rich in this country, and in so doing we are not hurting the rich, who protect themselves by perks, by deferred compensation plans, by 401(k) pension plans, by municipal tax-free bonds——

Connie, with all due respect to the party of Abraham Lincoln, is somebody going to speak out against raising income tax rates? It is easy to speak out against a Social Security tax. It is easy to speak out against energy taxes if you are from Florida.

When is somebody going to speak out against raising income tax rates by 40 percent that Larry Cudlow said will reduce GNP by 20 percent over 4 years, result in 4 million lost jobs, $200 billion higher deficits, and about $700 billion in additional revenue? Is anybody going to say anything?

Senator MACK. I will check.

[Laughter.]

Mr. KEMP. Well, you knew what would happen if you invited me up here. I was not going to come up here just to talk about enterprise zones.

Senator MACK. I think I have to go at this point.

[Laughter.]

Mr. KEMP. I assume you took that as teasing, because I know you have been doing it, you and Trent Lott and Bob Dole, but it really is important that we defeat this whole income tax proposal and increase in the capital gains. I know that you have been championing this——

Senator MACK. Well, let me stay for one more moment.

[Laughter.]

Senator MACK. I want to pick up on a comment that you made and a thought that I have, and that is this, and you picked up on the word, I think it was to "seduce" business into the enterprise zones, and there is this idea that if capital flows in the only way

the enterprise zones are going to work is if somebody comes in from the outside and creates a new business.

Implied in that is there is not a natural instinct on the part of human beings to make their lives better, and my feeling is that if you let capital flow in, like oxygen, all of a sudden you are going to see a burst, a flame, a new idea. A new business is going to be formed.

There is nothing wrong with the people in the inner city. What they need is an opportunity. What they need is a chance. What they need is some capital, and so without the incentives that have been removed from the Finance Committee's bill, this is going to fail, and that is what I said earlier.

My concern is we are going to end up with an enterprise zone concept that is so watered down that the opponents of enterprise zones will be able to point in a few years and say, see there, it did not work.

I think part of what we have to add to our discussion about the importance of enterprise zones is there are people all over Liberty City and Overtown who are dying for the opportunity to have just a little bit of capital, get the regulations out of the way, give me an opportunity to start my business, and it will work, but we have to let that take place, and I think we have to start making that point.

In our discussions about enterprise zones, we are not trying to put capital into an area by getting some white entrepreneur from Cleveland or from Jacksonville to invest in Miami. We want to give the people of Miami, of Overtown, of Liberty City the opportunity to create their own businesses.

Mr. Kemp. That is a beautiful statement, and I apologize for the teasing way that I brought up the overall tax plan before, because I know what you have done, and right then and there you have said something that is profoundly important.

There is economic activity going on in the inner city. Unfortunately, it is underground. People are responding to the wrong rewards. The rewards of the inner city commonly are basically for doing everything that leads to what you rightly and correctly quoted from Hernando de Soto's book, The Other Path, the story of what happened in Lima.

Eighty percent of all the housing that is built in Lima is built underground. I do not mean underground physically, but in the underground economy, because it takes 3 years to get a permit to build a house in Lima, Peru. It is starting to look like Southern California. You cannot build affordable housing in Southern California because of various regulations and taxes and fees, and then we wonder where is the housing, and we shed crocodile tears for the new families that cannot get homes, but we have regulated it away.

Your point is that there is tremendous activity going on, but unfortunately it is in a gray, underground economy. It is off-the-tax-rolls economy. Look at the smuggling of cigarettes from North Carolina to New York. New York has the highest per capita tax on cigarettes in the country. North Carolina apparently has the lowest, so it's big business smuggling North Carolina cigarettes into New York.

That is an example of that curve first talked about by Adam Smith, in which he said, never raise taxes to the point at which it discourages the industriousness of a people, because it does not raise revenue, it loses revenue. This bill will lose revenue. I will guarantee you, it will lose revenue. You will end up spending money, and emulating model cities.

I cannot believe the Secretary of Treasury representative up here, or Andrew Cuomo, was talking about model cities. That is a model of how to fail. I do not say that to be meanspirited. I just say, it is not going to work, and we ought to do something to make it work.

I really applaud your efforts. I know that I have abused our friendship by holding you accountable for the whole Republican Party in the Senate.

Senator LIEBERMAN. Believe me, he has taken much worse than that since he has been here.

[Laughter.]

Senator LIEBERMAN. Thank you. Thank you Connie, Jack. I had five questions, and you have answered them brilliantly.

We are in a tough situation. Obviously, I share your frustration that this proposal took us back to where we were a year ago, and we won that battle. We got them up to a larger number of zones. We put capital cost incentives in, and yet here we go again.

Now we are in a procedural bind because the Finance Committee is not going to put the program in. I thought they would have it included, and all I would have to argue about is how to spend the tax incentives. Now I have to try to find a way to amend to get the whole program back in. Clearly, as you know, there is a lot of support for this in the House. The Black Caucus has made this a priority.

Mr. KEMP. What happened to the Bumpers bill? What happened to the Bumpers enterprise zone bill in the Senate? That was at least a beginning.

Senator LIEBERMAN. The Democrats, I regret to say, on the Finance Committee have totally knocked out the targeted capital gains tax from the proposal and Dale is outraged—the Chairman of this Committee—and he is going to lead an effort to put it back in on the floor, and I think we are going to be able to do that successfully.

In addition to that, the Committee did raise the capital gains rate as I think you suggested and said earlier, so there is a lot of work to do, and there is a fundamental disagreement here which I do not get, because I agree with you.

The truth is, almost any economist you talk to regardless of what they say, their ideologies will tell you that we suffered in America, obviously in the poor areas, but generally from a lack of investment, and one way to deal with that clearly is to free up the equity markets, and this is a way to do it.

We can unleash so much more money with a decent capital gains approach than we would ever have thought about putting into a so-called stimulus program that it is ridiculous. Anyway, it is reassuring, refreshing, inspiring, and I must say personally reinforcing to hear you, and I thank you for your time. I am sorry we kept you late, but I appreciate it.

Mr. KEMP. Well, I cannot leave, Joe, without saying one last little postscript to my testimony. You mentioned Bobby Kennedy. I think it was last Sunday that was the 25th anniversary of his passing, and I say this with all sincerity, since you reminded me of it when you brought up the fact that he and Bedford-Stuyvesant was very interested in this whole concept, and I am sorry that it has become a Republican-Democrat or liberal-conservative or Kemp-Cisneros issue. I introduced Henry Cisneros to the Senate and applauded his appointment.

But Bobby Kennedy said over 25 years ago that to fight poverty without private enterprise is to fight or combat a war and leave your army on the sidelines. He believed strongly in using incentives, and rewards for productive private entrepreneurial business-type activity, and it seems to me, if we can get over this issue of the politics and what the name is going to be, and we have got to get over the deficit mania that is driving this debate, I think at that point then we can do something about the inner cities of America and the poverty.

Maybe we need a new way of talking about the issue, and if it would help, I will not come up and testify any more. Obviously, this is my 29th testimony on enterprise zones in 13 years, and I do not know, maybe I am an obstacle to the passage of it.

Senator LIEBERMAN. You are not at all.

Mr. KEMP. I really appreciate what you have done. I know you have got a lot of guys in the Republican Party who would like to support what you are doing, and I know there are some discerning Democrats in your party who would like to do something radical about the conditions of unemployment. I am going to Connecticut for the Republican Party next Monday night, and I am going to mention two Democrats—Scoop Jackson and Joe Lieberman.

Senator LIEBERMAN. Thank you, Jack. You are great. Good luck.

Mr. KEMP. I wish you well.

Senator LIEBERMAN. Thanks for being here.

Let us call the third panel, Michael Allan Wolf, Richard Cowden, and Paul Pryde.

Thanks very much to the third panel. We appreciate your patience. Let me suggest that if you have a prepared statement we will take it for the record, and if you could, try to limit your opening comments to maybe 5 or 6 minutes and we can have a conversation as we go on.

We will begin with Dr. Michael Allan Wolf, professor of law and history and director of the Enterprise Zone Project at the University of Richmond.

STATEMENT OF MICHAEL ALLAN WOLF, PROFESSOR OF LAW AND HISTORY, DIRECTOR, ENTERPRISE ZONE PROJECT, UNIVERSITY OF RICHMOND

Dr. WOLF. Chairman Lieberman, I am pleased to be here to talk about enterprise zones once again.

For the past 12 years, much of my research, writing, and teaching has been devoted to this topic, and I am honored to appear before the Senate Small Business Committee on this topic.

Now, of course, it is called empowerment zones and enterprise communities.

Senator LIEBERMAN. We have not talked about that yet today. That has been an interesting movement of nomenclature here, that the empowerment zones are what we think of as enterprise zones, although they are not fully enterprise zones. The enterprise communities are definitely not enterprise zones.

Dr. WOLF. Well, they could be.

Senator LIEBERMAN. They could be with a little help, doctor. Go ahead.

Dr. WOLF. On May 27, which was only 3 weeks ago, that was the same day the President's proposal was passed as part of the House deficit reduction plan, I participated along with Dick in a roundtable discussion with members of the House Subcommittee on Economic Growth and Credit Formation.

I have attached to my written testimony a list that I prepared for that hearing of the most prominent public policy issues associated with enterprise zones. On that date, the discussion was primarily focused on the nontax incentives contained in the administration's proposed Economic Empowerment Act of 1993, and that was, of course, because the House was about to pass the tax incentives. What a difference 3 weeks makes.

Today, Federal enterprise zones are yet again in jeopardy, and I use the term, yet again, because of the pattern that we have seen for the last dozen years.

The President champions enterprise zones. They are included as part of an economic stimulus, tax reform or urban aid package, and then they end up on the cutting room floor before or during conference.

Last fall, the pattern shifted a little bit when President Bush vetoed the tax bill that included enterprise zones. This time, the scissors have been wielded by the Senate Finance Committee as the members searched for incentive programs to cut in order to make up for the elimination of the BTU tax.

For thousands of impoverished and unemployed Americans in central cities and rural areas, this move will have significant consequences, for empowerment zones and enterprise communities offered the best hope in more than a decade for a constructive public-private partnership supported by real Federal dollars and technical assistance and targeted to the Nation's pockets of distress.

As this hearing indicates, the fight to enact Federal enterprise zones is not yet over. The President last night and leading Members of the House—like Representative Rangel—have pledged to work diligently to ensure that enterprise zones are part of the final budget reduction package that emerges from Congress, and your presence indicates that you will do the same thing.

I would like to emphasize three major points, much of which is covered in my written testimony, but I will just glance over some of these points. The first point has to do with the topic of State and local experience, and I think I would like to sum up by saying that State and local enterprise zones, despite some setbacks, are alive and well, though in need of a Federal boost.

Up to this point, the discussion of Federal enterprise zones has been largely theoretical, but we are already in the second decade of

State zone activities, and zones have evolved from what was originally an anti-Government supplyside concept into a true public-private partnership in urban, rural, and suburban communities.

I would not like to recite or debate the Government-generated figures that proclaim the hundreds of thousands of jobs and billions of dollars investment in State enterprise zones. I think it is more revealing to sample from the experiences of businesses and State and local officials actively involved in enterprise zones.

In my written testimony I have included some excerpts drawn just from 1993 alone, from the Nation's newspapers, stories about businesses in enterprise zones and about local government activity in enterprise zones, and these are excerpts that describe successes in enterprise zones, and I think it is important that we define what a success is in a depressed urban-rural area.

Often, it is putting the brakes on decline. That is, an area might lose 100 jobs in a year, but that might be a success if 3 years before or a year before designation they were losing 500 jobs, or 1,000 jobs.

Senator LIEBERMAN. I appreciate that you have done that in your testimony because that is just what we need at this point to confront the skepticism about whether these have worked.

Dr. WOLF. I think it helps just to have names of companies and individuals who have benefited from the zone incentives.

I am not going to read these excerpts in my written testimony, but the first involves a small manufacturing concern in California, and shows that manufacturing businesses can benefit from enterprise zones. The second involves a family retailer in a New Jersey zone. The third is a grocery store in an inner city area in Indianapolis.

The next example is, I think, probably the most interesting example I picked up when I was doing the search, and that is that Santa Ana, CA, was chosen in the latest round of selections for enterprise zones in California. In a newspaper article in the Los Angeles Times it was reported that Anaheim officials who had lost out on the competition remained upbeat, extending congratulations to Santa Ana and expressing confidence that Anaheim will reap an economic spinoff from any increase in commerce experienced by its neighbor.

I think that is an important point. That is what I have identified as the fairness problem with enterprise zones. Why we were not chosen to receive the incentives is often what you hear theoretically neighboring areas say, but if those neighboring areas themselves are marginal, there is a good chance that the area that is selected as an enterprise zone will boost business not only within the zone but in the marginal area next door, and here is a good example of anecdotal evidence that that can happen.

The next example that I culled from the computer data base was a city distributor, a food distributor within the inner city in Atlanta who had decided to stay because changes were made in the enterprise zone program to allow him to qualify for the incentives.

The next example is of 300 service jobs that were attracted to an Ohio enterprise zone. What seems to have done the trick were local incentives that were passed by the city council as part of the State and local enterprise zone program in Ohio.

The next is an example from Hartford, CT—in fact, start-up capital problems that were overcome by a window manufacturer in Hartford.

Senator LIEBERMAN. I have been there to that manufacturer.

Dr. WOLF. This is an example of the delay that can be caused because of the problems of getting start-up capital. Here is someone who is employing several people who located and expanded his business in an enterprise zone, and we can only think if there had been start-up capital 2 years before, maybe he would be expanding even more today.

The next is an example of community-based technical assistance in the California—an L.A. area enterprise zone. Barrio Planners, Inc. is operating the center with the city's Community Development Department to provide assistance in business planning, bookkeeping, marketing and organization, which points out that there is something more than tax incentives in many of the State and local enterprise zones.

The final example comes from Virginia, the Norfolk zone, about a native of Norfolk who decided to relocate his construction business within the Norfolk enterprise zone, to move from one section of the city to another. He talks about the fact that the enterprise zone incentives were influential in helping him arrive at his decision, but more importantly, according to the article, his contact with the city did not stop with the move. "They called me every few months asking me how it is going and if I am happy with city services."

So I think that is just a quick run-through of some of the kinds of stories that we are seeing in State and local enterprise zones.

Senator LIEBERMAN. Those are fairly fresh, are they not?

Dr. WOLF. All are 1993 stories. I think my computer might have blown its hard drive if I tried to load all of the stories for the last 5 or 6 years, even.

Not all the State and local experience, however, have been favorable, and I think we have to admit that, and I cite a couple of telling examples in my written testimony as well.

One involves the Altadena-Pasadena enterprise zone in California, and a manufacturer who decided to leave and to take 700 jobs with it. The incentives in that zone apparently were not enough, and here is an example of a zone program that perhaps needs that extra boost from Federal incentives.

A second example comes from the State of Florida, a town in Florida that did not live up to its promises. In order to receive zone designation it promised breaks on license fees, issue bonds for redevelopment work, to earmark Federal grants, and so on and so forth, and these commitments turned out to be paper promises, according to a newspaper article on the subject.

I think this points out that there is a need for a governmental presence in the enterprise zone, a State governmental presence, an oversight presence, and of course with Federal enterprise zones there is a role for the Federal Government to play, not to dominate the scene, but to make sure that businesses are held accountable and that local governments are held accountable if they are chosen to participate in this program.

The other thing that I discovered, that we have discovered, is that enterprise zones are not dying. In fact, the contrary is true, and I have to update some of your figures.

The most common figures we hear is that there are 36 States or 37 States plus the District of Columbia with enterprise zone acts. In reality, the number is probably 40 or 41 at this point. Nebraska last year passed enterprise zones, and this year alone, in 1993 alone, Massachusetts has created economic opportunity areas and economic target areas.

New Mexico has just authorized enterprise zones for the first time, and last month Iowa enacted Senate bill 11, creating agricultural enterprise zones.

When you look at the list of bills that are introduced in State legislatures in just 1993 alone, in over 30 States I counted more than 280 bills that had been introduced as a way of fixing up enterprise zone programs, so it is not like this is a static activity. It is not like they are dying.

What began as a wait-and-see program—that is, we will pass our own program and wait for the Feds to come down with their program and give us their blessing—has turned into a national movement, a national movement that is growing, and in which corrections have been made.

Despite the testimony to State and local innovation in the face of significant Federal funding cuts, however, observers of State and local enterprise zones almost universally agree that the right Federal zone program would ensure even greater progress toward economic rebirth for the Nation's most distressed areas.

Moreover, Congress should carefully consider the effect yet another failed effort would have on the good soldiers fighting the economic development and neighborhood revitalization fight on the front lines.

As Dick will tell you, every few months the folks who are fighting that good fight in the States and localities get their hopes up that there will be a Federal enterprise zone program, and to be honest with you, any Federal zone program will garner the attraction of the national press.

A lot of localities that know they will not get zone designation know they will get something—the spillover effect from there being a Federal program. Their hopes go up and they go down every time Congress appears to be on the brink of enacting enterprise zones and then drops them onto the cutting room floor.

The second point I make in my testimony is that the Clinton administration's proposal is much more in tune with the State and local experience with enterprise zones than in previous packages of incentives designed for Federal zones, and I think that this morning and now getting into the afternoon we have heard a lot of testimony about the incentive package or the approach that is taken.

There is a governmental presence, there are tax incentives, and so forth, and so I do not really want to go into that, except to talk about one thing, and that was that the Clinton administration recognizes for the first time in a major Federal enterprise zone bill that there are severe disincentives to investment in distressed areas that cannot be overcome simply by reducing taxes or relaxing regulations.

I have identified six barriers to significant investment and increased employment in many if not most of the Nation's most depressed communities: scarcity of a trained, educated work force, widespread public safety concerns, outdated land use plans, crumbling infrastructure, prohibitively high insurance rates, and environmental abuse.

Some of these concerns are directly addressed by the tax incentives and local planning incentives included in the House-passed bill. Others would be appropriate targets for the enterprise grants that Assistant Secretary Cuomo discussed and for the zone priority investments that are included in the Economic Empowerment Act proposal.

Let me skip on to my third point, one that I know that you are very interested in. I would say that the incentive mix offered in the current proposal, the tax incentive mix, though impressive, might well be enhanced in order to accomplish the administration's goals, not to accomplish the goals of somebody else, but the very goals of the administration.

The decision to go with some labor-based as opposed to capital-based incentives gives the current proposal an advantage over some previous formulations. However, because so many new small businesses are not profitable in their early formative life, and because too many fail, as you pointed out, many empowerment zone businesses will be unable to take advantage of the most important tax incentive in the package—a nonrefundable employer tax credit.

Refundability is, of course, a theoretical option but not a politically feasible one in deficit-crunch times like these.

There are options to refundability, however. This is a way of addressing your problem that maybe those incentives will not be used up in the enterprise zones or the empowerment zones, and that is, one could enhance the earned income tax credit for zoned business employees, ratchet it up even higher, and maybe even make that credit available to persons who are currently ineligible to receive the EITC, such as individuals who do not have children. This would perhaps increase teenage employment in depressed areas.

The second thing that the House and Senate could do is to institute an employee tax credit that might be used up, as opposed to the employer credit. Either program would reduce the employer's labor cost even if the business had no Federal tax liability.

Another barrier that you have identified to success for new, small, home-grown businesses in targeted areas is the unavailability of start-up capital, a need that will not necessarily be addressed by locating community development banks in the zones.

Earlier versions of Federal enterprise zones contained expensing and capital gains deferral provisions for those interested in investing in stock and EZ businesses. Some critics of this tool have observed that such tax shelters direct the benefits of the federally subsidized zones beyond the zone borders, and I think that is a valid criticism.

However, Congress could easily investigate ways of ensuring that those persons who are financially invested in the zone business are also emotionally invested in the life of the enterprise zone. This emotional investment could be crucial to the success of a marginal enterprise zone.

Often, the movers and shakers in our economy are those professionals who render tax and investment advice to individual and institutional investors seeking the highest return for their investment. Enterprise zone incentives should be directed to those investors—they could, for example, package enterprise zone mutual funds, as one example. These incentives, directed to investors, would catch the attention of these advisors, particularly as tax rates rise and deductions dwindle for wealthier taxpayers.

Thank you for the opportunity to discuss these aspects, and I look forward to answering your questions.

[The prepared statement of Dr. Wolf follows:]

Prepared Statement of Michael Allan Wolf

Chairman Lieberman and Members of the Subcommittee, my name is Michael Allan Wolf. I am Professor of Law and History (specializing in land-use and environmental law), and Director of the EZ (Enterprise Zone) Project at the University of Richmond. For the past 12 years, much of my research, writing, and teaching has been devoted to the topic of enterprise zones and zone programs at all levels of government. I am honored to appear before Members of the Senate Small Business Committee on the topic of President Clinton's Empowerment Zones and Enterprise Community proposal.

On May 27, the same day the President's proposal was passed as part of the House deficit-reduction plan, I participated in a roundtable discussion with Members of the House Subcommittee on Economic Growth and Credit Formation. I have attached to this testimony a list, prepared for that hearing, of the most prominent public policy issues associated with enterprise zones. On May 27, the discussion was primarily focused on the incentives contained in the administration's proposed Economic Empowerment Act of 1993. What a difference 3 weeks make!

Today, federal enterprise zones are yet again in jeopardy. I say "yet again" because of pattern for the last dozen years: EZs, championed by the President, are included as part of an economic stimulus, tax reform, or urban aid package, only to end up on the cutting room floor before or during conference. The pattern shifted only slightly last fall, when President Bush vetoed the tax bill that included EZs. This time, the scissors were wielded by the Senate Finance Committee, as its Members searched for incentive programs to cut in order to markup for the elimination of the BTU tax. For thousands of impoverished and unemployed Americans in central cities and rural areas—this move will have significant consequences, for Empowerment Zones and Enterprise Communities offered the best hope in more than a decade for a constructive public/private distress supported by federal dollars and technical assistance, targeted to the Nation's pockets of distress

As this hearing indicates, the fight to enact federal zones is not yet over. The President and leading Members of the House have pledged to work diligently to ensure that EZs are part of the final budget-reduction package that emerges from Congress. In the context of this continuing debate, I would like to emphasize three major points today:

FIRST, State and local enterprise, despite some setbacks, are alive and well, though in need of a federal boost. While discussion of federal enterprise zones has been largely theoretical to this point, we are already in the second decade of state zone activity. EZs have undergone an impressive evolution from the original concept of anti-government, supply wide showpieces targeted solely to urban distress to the current reality of public private partnerships directed to revitalization and economic development for hundreds of urban, rural, and suburban communities throughout the Nation.

Rather than taking the time to recite (or debate) the government-generated figures that proclaim hundreds of thousands of jobs and billions of dollars in investment in state zones, it is more revealing to sample from the experiences of businesses and state and local officials actively involved in actual EZs. Here is a small sampling, drawn just from 1993 news accounts, of the kinds of successes American communities are experiencing every day in zones throughout the Nation:

- "A Taiwanes owned manufacturer of 'thin film' for floppy disks will build a new factory in Sacramento's Northgate/Norwood Enterprise Zone.
- Intermag Inc. expects to employ 78 to 100 workers in an American subsidiary based here.—*Sacramento Business Journal*, January 4, 1993.

• "One (EZ retailer] is Elliot Braha, whose family has run Lord's, a childrens' clothing store in Journal Square [Jersey City] for 35 years. The revenue from the sales tax gives us the weaponry to compete with suburban malls and combat urban decay, said Mr. Braha, who also heads the Journal Square Merchants Association."—*New York Times*, January 10, 1993.

• "Cub Foods is planning to open a 68, square foot store this spring in the old Meadows shopping center, employing almost 300 people and bringing a grocery store to an economically distressed neighborhood that has been without one for years.

Located at 38th and Dearborn streets, the abandoned shopping center targeted by Cub is smack in the middle of the Indianapolis Urban Enterprise Zone, an area set up to attract such developments with a slew of tax incentives. "Indianapolis Business January 18, 1993.

• "Gov. Pete Wilson announced Monday that Santa Ana has been picked as a state 'enterprise zone,' giving the economically depressed community an enticing menu of business tax credits and other incentives to woo new manufacturing firms and keep others from bolting out of town. . . .

While the governor's announcement was good news for Santa Ana, it left out Anaheim, which had been competing to be an enterprise zone. But Anaheim officials remained upbeat, extending congratulations to Santa Ana and expressing confidence that Anaheim will reap an economic spinoff from any increase in commerce experienced by its neighbor."—*Los Angleles Times*, February 2, 1993.

• "It would have been easy for Russell McCall to leave behind the headaches of high taxes, the occasional break-ins and vagrants, and flee to the suburbs. But the 49-year-old entrepreneur wanted to keep his expanding wine and food distribution in the city.

Mr. McCall spearheaded an effort to get 18 acres in Atlanta's South Central Business District designated as a commercial enterprise zone. This gave him the tax break he needed to build a new wine warehouse, part of a project that begins next month.—*Atlanta Constitution*, March 28, 1993

• "Federated Department Stores Inc. chose to centralize its accounting operations—and the accompanying 300 jobs—in Greater Cincinnati after considering sites in Northern Kentucky and Atlanta. Incentives of nearly $1.5 million from the state, Hamilton County, the city of Cincinnati and the city of Sharonville helped the company make up its mind....

Federated also received tax incentives from Hamilton County for locating in an enterprise zone in the city of Sharonville. Sharonville held a special City Council meeting to approve the benefits."—*Cincinnati Business Courier*, April 5, 1993

• "Ladizki has a clear vision for his business and for this struggling neighborhood [Hartford's EZ]. It's a view, however, that he couldn't get banks to see. Two years ago, he needed capital to start a window-manufacturing business. But the economy was falling like a house of cards and Ladizki had doors shut in his face....

Undaunted, he plunged ahead. With financial backing from two contractors, he started Landmark Window Systems Inc. at 3080 Mains St.

A year ago, he bought another window company in Hanover, MA, March 1 moved Wes-Pine Window Systems Inc. to 2964 Main St. in the enterprise zone."—*Hartford Courant*, May 4, 1993

• "In an effort to help businesses in the Eastside enterprise zone area, a new help center has been established to offer bilingual training, counseling and other services.

The Eastside Business Assistance Center... provides assistance in business planning, bookkeeping, marketing and organization. The office will also offer lowest business development workshops and free assistance in applying for business loans, said Anita Garcia of Barrio Planners Inc., which is operating the center with the city's Community Development Department."—*Los Angeles Times*, May 16, 1993

• "Norfolk's outreach extends to businesses large and small. Curtis Cole, owner of a 35-employee construction company, said the city's attention has been instrumental in his decision to remain in the community where he grew up and attended college.

About 18 months ago, Mr. Cole relocated his Curtex Construction operation from another part of the city to Norfolk's enterprise zone, allowing him to take advantage of some tax benefits and below-market-rate financing.

But his contact with the city did not stop with the move.

'They called me every few months, asking me how it's going and if I'm happy with city services,' he said."—*City and State*, June 6, 1993

Not all of the state and local experience has been favorable, however, as seen in the following recent news accounts:

- "Because owners of an Irwindale property made and irresistible offer, a major private employer in northwest Pasadena has elected not to move, striking a blow to a state program to encourage business and jobs in that area. . . .

  Ready Pac managers told Irwindale officials that they would bring 700 jobs with them and the potential to expand that by 300 more positions....

  Ready Pac's decision comes less than six months after the Altadena-Pasadena Enterprise Zone was inaugurated in northwest Pasadena, with the express purpose of giving one of the region's most downtrodden areas an infusion of economic energy. "—*Los Angeles Times*, April 25, 1993

- "Seven years ago Umatilla [Florida] made a lot of promises to get selected.

  This rural Lake County town of 2,400 vowed to give businesses breaks on license fees, issue bonds for redevelopment work, earmark federal grants and reduce government regulations on businesses locating in blighted areas. . .

  These commitments turned out to be paper promises.

  Three years after entering the program, the state warned Umatilla that it had not carried out a single commitment.

  To this day, Umatilla has not given any business a license fee break, reduced its regulations, issued bonds, applied for any federal grants or kept its other promises, city officials acknowledge.—*Orlando Sentinel*, June 13, 1993

In an attempt to address some of these shortcomings, state legislatures have continually revisited their zone programs, makings changes where needed. In fact, in 1993 alone, thirty states have considered changes in existing legislation, ranging from increasing the number of target areas to major revisions of the incentives offered to participating businesses.

This year, three states have joined the EZ fold. In March, Massachusetts created "economic opportunity areas" and "economic target areas" under Senate Bill 1500; and New Mexico, under House Bill 223, authorized enterprise zones for the first time. Just last month, Iowa enacted Senate Bill 11 creating "agricultural enterprise zones."

Each of these new variations, and the changes made in existing programs, demonstrates the vitality and responsiveness of zone programs. What began as a "wait and see" program, enacted in anticipation of federal incentives, has grown into a national movement. Despite this testimony to state and local innovation in the face of significant federal funding cuts, however, observers of state and local EZs almost universally agree that the right federal zone program would ensure even greater progress toward economic rebirth for the Nation's most distressed areas. Moreover, Congress should consider carefully the effect yet another failed effort would have on the "good soldiers" fighting the economic development and neighborhood revitalization fight on the front lines.

SECOND, the Clinton Administration's proposal is much more in tune with the state and local experience with EZs than any previous package of incentives designed for federal zones. Bill Clinton is the third President to put enterprise zones on his agenda. Unlike his predecessors, however, President Clinton has had first-hand experience with EZs, as the governor of a state with a long-operating zone program. Not surprisingly, therefore, the Clinton Administration's vision of EZs is much more *in tune with the zone concept as it has evolved in states and localities* throughout the Nation:

- This is a *multi-laceted program that seeks to match the best government has to offer with the entrepreneurial spirit* of business (employers and investors) and the constructive activism of local residents. While the previous administration was strongly opposed to any governmental presence in the zones—as best typified by former HUD Secretary Jack Kemp's unrelenting attack on the "zone czar and on using EZs as target areas for existing federal programs—the current vision of EZs recognizes that the federal government may indeed be the *only* institution with the resources, the expertise, and the commitment to overcome some severe disincentives to economic rebirth of the Nation's most distressed communities. Government officials have long played a creative and crucial, though certainly not dominant, role in state and local enterprise zones. Under the Clinton Administration's plan, the federal government (in alliance with State and municipal officials) will be given that same opportunity.

• The current EZ proposal, for the first time, creates a *two-tiered approach to zones*, a strategy that sends a supportive message to the dozens of localities who are actively engaged—through state EZs and complementary programs—in public-private economic development and revitalization efforts. Under previous proposals, the fact that designation was an all-or-nothing proposition posed a problem for those communities that "lost out." In the administration's proposal, however, there is some significant consolation for the communities that are not chosen for the first tier of Empowerment Zones. To be selected as an Enterprise Community can be quite significant for local residents, employers, and investors. Those crafting the final EZ package should take care not to limit the number of targeted areas too severely, so as to avoid alienating the public and private actors in the more successful state and local programs.

• The administration's plan *distills much of the best of the state and local experienee*, while avoiding much of the worst. When, in 1992, I was asked by the House Subcommittee on Economic Stabilization to "offer specific recommendations," based on my study of EZs, "to improve proposed federal enterprise zone legislation," I highlighted six aspects that the collective state and local experience indicated would strengthen a federal program:

  • (1) *A competitive designation process* would allow communities (that is, local governments and community groups) to demonstrate that they have created a pro-business atmosphere in settings where, before designation, the private sector viewed itself as overburdened and unwelcome.
  • (2) *A limited experiment*, rather than a Nationwide entitlement program, would enhance program monitoring, administration, and marketing of the targeted areas (thus remaining true to the notion of a "demonstration" program, in contrast to the history of Model Cities).
  • (3) *Monitoring program performance* must be mandated and paid for up front, so that federal officials can avoid relying on the kind of post-hoc studies to which those analyzing state and local zones have had to resort.
  • (4) *Anti-pirating* language will help cut down on incentive shopping by businesses seeking the best package before moving on and leaving employees and dependent concerns behind.
  • (5) *Budget deficit concerns* make limits on tax incentives and on grant amounts sensible if not essential.
  • (6) *Program incentive packages must be flexible* enough to encourage a healthy measure of experimentation in the Nation's most distressed communities.

Each of these six aspects has been appropriately addressed either through the administration's proposal. Localities must *compete* for the *limited number* of Empowerment Zones and Enterprise Communities, in the process developing strategic plans designed to make full use of available public- and private-sector resources. Several officials are charged with *monitoring program progress*. The House bill contains *anti-pirating language* and *budget-senitive* caps on employer tax credits. There is an *ample mix of incentives* (tax credits, bond financing, grants, and regulatory flexibility), in this ambitious program, although, as noted below, that mix could be enhanced somewhat without compromising the administration's goals.

• The Clinton Administration program recognizes, for the first time in a major EZ bill, that there are *severe disincentives to investment in distressed areas that cannot be overcome simply reducing taxes or relaxing regulations*. Secretary Kemp was fond of reminding the Nation that business is the key to empowering residents of the Nation's pockets of poverty and despair. To Kemp enterprise zones were a "seed-corn" project, a theme picked up in Weed-and-Seed, another of the Bush Administration's inner-city strategies that sought to match economic development with anticrime measures. But, it makes little sense to plant seeds such as these in unprepared soil.

There are at least *six key barriers to significant investment and increased employment* in many, if not most, of the Nation's most depressed communities: scarcity of a trained, educated workforce; widespread public safety concerns; outdated land-use plans; crumbling infrastructure; prohibitively high insurance rates; and environmental abuse. Some of these concerns are directly addressed by the tax incentives and local planning included in the House-passed bill. Others would be appropriate targets for the Enterprise Grants (for example, moneys set aside for environmental studies or insurance-premium subsidies for zone businesses) and for the zone priority investments (for example, for schooling, job training, highway and sewer construction) included in the Economic Empowerment Act proposal.

• *Regulatory flexibility, not widespread deregulation,* is part of the administration's empowerment package. Rumors of wholesale elimination of government rules and regulations such as building codes, minimum wage, worker protections, and environmental codes have plagued EZs since they were first seriously considered in this country in the early 1980s. State legislators and administrators have consistently rejected this aspect of zones, while assuring workers and residents that public health and safety would never be bargained away for increased investment and employment.

Instead, for many localities zone selection has often preceded reformulation of rules and procedures to make doing business smoother and less complicated. One-stop permitting and zoning map adjustments can be found in operative EZs, not sweeping repeal of building code, licensing, and land-use provisions. This notion of streamlining regulations is a prominent feature of the Economic Empowerment Act. The two most conspicuous examples are the "single point of contact" provision and the Enterprise Board's (appropriately limited) waiver authority. There is much in the administration's program that suggests the same kind of responsive regulation that has occurred under the aegis of state and local EZs.

THIRD, the incentive mix offered in the current proposal, though impressive, might be enhanced in order to accomplish the administration's goals. The decision to go with labor-based, as opposed to capital-based, incentives gives the current proposal an advantage over previous formulations. However, because so many new, small businesses are not profitable in their early, formative life, and because too many fail, many Empowerment Zone businesses will be unable to take advantage of the most important tax incentive in the package nonrefundable credit. Refundability is, of course, an option, but not a politically feasible one in deficit-crunch times like these. There are options to refundability including enhancing the earned income tax credit for zone business employees (or even making the credit available to currently ineligible persons such as individuals without children), and instituting an employee tax credit. Either program would reduce the employer's labor cost, even if the business had no federal tax liability.

Another barrier to success for new, small, homegrown businesses in targeted areas is the unavailability of start-up capital, a need that will not necessarily be addressed by locating community development banks in the zones. Earlier versions of federal EZs contained expensing and capital gains deferral provisions for those investing in stock in EZ businesses. Some critics of this tool have observed that such tax shelters direct the benefits of the federally "subsidized" zones beyond the EZ borders. However, Congress could investigate ways of ensuring that those persons who are financially invested in the zone business are also emotionally invested in the life of the EZ.

This emotional investment could be crucial to the success of a marginal EZ. Often the movers and shakers in our economy are those professionals who render tax and investment advice to individual and institutional investors seeking the highest return for their investment. EZ incentives directed to investors would catch the attention of these advisers, particularly as tax rates rise, and deductions dwindle, for wealthier taxpayers.

I appreciate the opportunity to discuss these and other aspects of Empowerment Zones and Enterprise Communities (the new EZs and ECs for the 19905) with the Members of the Subcommittee and look forward to addressing your concerns.

ATTACHMENT

THE CLINTON ADMINISTRATION'S EMPOWERMENT ZONE ENTERPRISE COMMUNITY PROPOSAL

PUBLIC POLICY ISSUES FOR ROUNDTABLE DISCUSSION SUBCOMMITTEE ON ECONOMIC GROWTH AND CREDIT FORMATION COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS, MAY 27, 1993

Program Design Issues

(1) *Experiment or entitlement:* Have the States proved that EZs will be successful? Are there too few empowerment zones or too many enterprise communities?

(2) *Zero-sum game:* Do EZs create new jobs, or just rob Peter to pay Paul?

(3) *Labor mismatch:* People in cities, jobs in suburbs; why rebuild cities, rather than move people to jobs?

(4) *Deregulation and waivers:* The perils of removing "necessary" red tape.

(5) *Sophistication vs. user-friendly:* Walking the tightrope between fine-tuning the program and making it simple

(6) *Property vs. people:* Displacement or favoritism for zone residents?

Area Selection Issues

(1) *Fairness:* Why choose one community over another? What effect does selection have on nearby marginal areas? What are the best indicators of distress?

(2) *Micro-management:* EZs were supposed to be nongovernmental creatures, but the Clinton proposal defines a key role for federal officials; will this enhance or inhibit local creativity and innovation? Is government skilled at picking economic winners and losers?

(3) *Can losers be winners?:* Most distressed areas will not be able to get their act together in nomination process; should the State have a say in selection?

(4) *Top-down vs. bottom-up:* With all of this cabinet-level participation, what role is left for the community?

(5) *How big is too big?:* The identifiability problem.

Incentive Issues

(1) *Grants and priorities:* Do targeting and expenditures frustrate or enhance the zone experiment?

(2) *Capital vs. labor:* Do tax-based programs focus on capital at the expense of labor?

(3) *Incentive-shopping:* Picking up and leaving communities high and dry after the incentives are used up.

(4) *Business size:* Are small businesses engines of growth? Nonrefundable tax credits and struggling businesses.

(5) *No bang for a lot of bucks:* Determining costs per targeted job.

Senator LIEBERMAN. Thank you, Dr. Wolf. Tell us what the Enterprise Zone Project is.

Dr. WOLF. The Enterprise Zone Project began in the early 1980s, and what we do is, monitor State, local, and Federal enterprise zone activities.

Back in the early eighties, we published a national newsletter called EZ Gazette, in which we summarized for any number of interested persons the range of activity in State and local enterprise zones. I continue to do research and writing on enterprise zones. Basically, it is a monitoring and analysis project.

Senator LIEBERMAN. How did that happen to start at the University of Richmond?

Dr. WOLF. Actually it did not start at the University of Richmond. My original funding came from the Lincoln Institute of Land Policy in Cambridge, Mass., and the project was originally with me at the Oklahoma City University School of Law where I used to teach.

Senator LIEBERMAN. So it traveled with you.

Dr. WOLF. Exactly.

Senator LIEBERMAN. Good work.

Next, Dick Cowden, executive director of the American Association of enterprise zones. Thanks for being here, Dick.

STATEMENT OF RICHARD COWDEN, EXECUTIVE DIRECTOR, AMERICAN ASSOCIATION OF ENTERPRISE ZONES

Mr. COWDEN. Thank you, Mr. Chairman. I would like to start out by noting that we wish that we had you and 10 others like you on the Finance Committee. We probably would not be in the fix we are in going into conference. But I do congratulate you for your interest and your dedication, and also your staff for this program over the years.

We appreciate this opportunity to describe our view on national urban policy based upon the experiences of many cities and States that worked over the past several years with the enterprise zone concept.

Our organization represents these localities, and we believe that we have gained a unique perspective on ways in which Federal urban initiatives could dovetail with the ongoing activities of the State zones.

The zone concept as originally proposed by the Reagan and Bush administrations should be fundamentally reworked to take into account the real world problems of revitalizing the economically distressed areas.

For example, under the earlier model for the zones, local, State, and Federal Governments would be expected to comprehensively reduce taxes and regulations in selected areas with the anticipation that private investment would respond to the opportunities. What the States that followed these signals learned, however, was that tax relief alone simply does not amount to a redevelopment strategy.

Beginning in 1985, our organization actively encouraged cities and States to incorporate a more direct approach to the problems of low-income areas. Job creation incentives may have their place, but we have found that cities and States willing to repair infrastructure, improve security, upgrade housing, provide training, and remove signs of blight, tended to generate far more favorable results from their zone programs.

We were pleased that the Clinton administration's zone proposal has incorporated three specific themes that we suggested. First, the new plan will not rely solely on tax incentives but will include a sensible system for targeting of programs and benefits that already exist in the Federal budget. This will help move the policy away from the one-size-fits-all approach of the past to one that is more tailored to the circumstances of each city.

Second, we suggest that the policy requires a more proactive planning process by local applicants. Indeed, the new plan would challenge cities and States to think through the problems of their zones and to propose a thoroughgoing set of responses rather than just offer tax benefits.

Finally, we recommended a two-tier designation system that should provide a baseline of support for all areas meeting the eligibility criteria for the program, plus deeper incentives for zones selected through a competition.

The track record of the State zones tells us that this process by itself would do far more to boost the effect of the zones than many would predict. Surveys of our own members indicate that the very opportunity to be included in such a national policy will mobilize cities and States to work more closely together to target low-income areas.

Under the new Clinton plan, zones would receive tax credits in varying degrees for hiring residents and enhanced investment expensing benefit, accelerated appreciation, tax-exempt bonds to finance improvements in capital acquisitions, and a tax credit for companies established as employee stock ownership corporations.

Because the administration's proposal entails tax expenditures, choices must be made as to how these benefits should be allocated to an upper tier of zones. We have envisioned the competitively designated zones not as demonstrations of the zone concept itself, which the States already have adequately demonstrated, but primarily as testing grounds for various economic initiatives. Over time, we may select new zones to experiment with individual measures that would be too costly to implement Nationwide.

The benefits to be considered should not be limited to tax incentives. We can imagine any number of innovations that might be useful in zones oriented around trade development, retail area revitalization, rural economic diversification, and even military base conversion.

As it carries out the Federal component of the policy, the Clinton administration should place the greatest emphasis on coordination with and support for all of the zones. If the perceived value of the upper tier zones overshadows all other aspects of the policy, we will have accomplished little in developing a multilevel system.

Every zone-eligible area should have access to Federal benefits that have little or no net budgetary impact. I have appended to our testimony a few of the possible advantages that could be offered to all of these localities. If we have time, I would like to perhaps touch on some of them, because I think that the implications of them indicate that there may be more at stake here than even with the tax incentives.

Allow me to explain why we have placed so much emphasis on the importance of the general approach that we have recommended. Since enterprise zones first were introduced in the early 1980s, Federal decisionmakers have faced what seems to be an impossible dilemma. If the program benefits are offered too idly, there is concern that the results will be anemic. If they are too generous to a small number of communities, we cannot afford to replicate favorable results in all areas that need assistance.

But the flaw in this conceptualization of the policy is that it views the Federal program as doing all of the work, operating in a vacuum. The two-tiered model offers a third alternative that is rooted in our observations of the State zones. It acknowledges that the overall success of a Federal zone policy will not hinge on the effect of any given Federal incentive. The far more promising prospect is that the very expression of commitment represented by a Federal zone policy will, in and of itself, move the cities and States to focus more attention on the needs of their most distressed areas.

Ultimately, the Federal Government will not rebuild cities. The cities and States can and must accept this as their responsibility. But the Federal Government can play a strong catalytic role in this process, and enterprise zones can provide a useful framework for understanding better how all levels of Government should work together in pursuing this goal.

[The prepared statement of Mr. Cowden follows:]

PREPARED STATEMENT OF DICK COWDEN

We appreciate this opportunity to describe our view of a national urban policy based on the experiences of the many cities and states that have worked over the past several years with the enterprise zone concept. Our organization represents

these localities and we believe we have gained a unique perspective on ways in which a federal urban initiative could dovetail with the activities of state-designated zones.

Since our organization formed in 1985, we have tried to communicate one fundamental theme to federal urban policy makers. It is based on the observation that many cities and states themselves have successfully adapted the original enterprise zone concept to their own unique needs and circumstances.

With more than 800 zones in operation in 38 states, the goal of a related federal initiative should be to reinforce constructive local redevelopment activities. In other words, the cities and states already have given us a well-tested and useful framework for a national urban policy; they are not looking for a new demonstration zone program but support for the ones they already have.

In the early 1980s, the first several state-designated enterprise zones were based on relatively low-level sets of tax incentives. However, over time many found such benefits alone did not adequately address the multiplicity of economic problems that beset inner cities.

In recent years, cities and states have increasingly turned to a more comprehensive approach to zone-based revitalization efforts, combining incentives for business investment with a concerted effort to improve infrastructure and living conditions for zone residents. No longer are enterprise zones considered merely a local application of supply-side economics.

The Clinton administration has grasped this important shift in the way local governments now regard these programs. Accordingly, it has designed a new federal zone policy that reflects this more balanced approach.

Congress should act to approve the empowerment zone bill in ways that build on the ongoing work of the states. This would for the first time form a linkage among local, state and federal responses to the needs of low-income areas.

It would have effects far beyond any federal investment incentives in the law because it also would establish a way to reward cities and states that work harder to address problems in their most distressed neighborhoods. At this level of integration, the concept distinguishes itself from the array of individual programmatic measures that lawmakers might recommend. It becomes a true policy.

This summer's deliberations on the zone proposal should begin with the consensus that developing a policy itself is more important than any given feature it comprises. Congress should work for an optimal mix of programs to implement through the policy, but they should anticipate revisiting the legislation as we learn more about its effects and as new ideas emerge.

It should develop legislation that takes into account what the states are doing that has been beneficial. The State of New York, for example, offers the zones preference in allocating all forms of economic development assistance that it has at its disposal.

The State of California offers a generous zone benefit package but requires applicants to identify specific sources of economic distress and to pursue a comprehensive strategy for the nominated areas recovery. This underscores the program as a partnership involving local and state responsibilities.

In New Jersey, a special fund has been established to respond to the unique problems of each zone. These monies have been used to repair streets, improve street lighting, purchase additional patrol cars, upgrade public facilities and remove signs of blight. Zone administrators have reported using the funds to leverage additional investment in infrastructure on the part of developers who acquire buildings in the zones.

The State of Indiana also has improvised a creative way of converting tax benefits for zone businesses into funds that contribute to the long-term vitality of the neighborhood. The effect in New Jersey and Indiana has been palpable. In many of their zones visible signs of recovery are clearly in evidence. And in the final analysis, such outward expressions of a city's and state's concern for the future maintenance of its urban areas sends a strong signal to the real estate, development and banking sectors.

Some cities have established challenge grants to encourage shopkeepers to brighten store fronts. Housing rehabilitation programs and paint donation programs are becoming common zone-related activities. Zone officials have worked with volunteer organizations to conduct fix-up/clean-up campaigns and block watches. One-stop permitting centers in zones are cutting red tape for large and small businesses.

More and more utilities are working successfully with cities and states as partners in the redevelopment process. In several cases they have offered discounted rates and other benefits to new customers in zones.

Our organization is working with the Federal Transit Administration (FTA) and five communities to demonstrate new ways of improving transportation alternatives for zone employees and residents. We anticipate that as we learn more from these limited applications of targeted assistance, we may design better approaches to providing daily transportation services in urban areas.

We also have been working with the national Association of Federal Credit Unions (NAFCU) to provide assistance to zone-based community groups in establishing financial institutions that are more responsive to the needs of residents.

Individually, none of these measures represents a dramatic change for a city with an enterprise zone. What is significant, however, is that they indicate zone officials are learning from their own experiences and from those in other cities and states.

The expansion in activity of this nature is the most important trend in enterprise zones around the United States since the mid 1980s. And yet most of these kinds of benefits and improvements are not reflected in cost/benefit analyses that have been conducted on the states' zones.

Indeed, how do we quantify a gradual change in the perception of security in a neighborhood? How do we account for the long-term job creation and investment impact of trees planted on a once-blighted street, or of a sidewalk made less hazardous to pedestrians? We all understand intuitively that these are the steps cities must take to revitalize decaying neighborhoods. We all realize that cities whose tax bases have been eroded should receive help from the states in making these improvements. This is what redevelopment planning should be about.

We commend the Clinton administration for proposing an empowerment zone policy that will induce participating cities to identify the sources of economic decline and formulate realistic plans for dealing with it. Any mature approach to a national urban policy is based on the understanding that there simply are not enough federal resources, whether through tax incentives or direct funding, to solve the problems of every low-income area.

This is in part the reasoning behind our recommendation, which the empowerment zone proposal incorporates, for a two-tiered designation system. We have envisioned a zone-based targeting mechanism that by itself does not cost the taxpayer anything. The first tier of participants should be composed of applicants with areas meeting an agreed-upon standard of distress that propose a strategy for joint state/local commitments to bring about improvement.

Washington's first option in developing programs to correspond with these local commitments should be to begin developing budget-neutral benefits that could be made readily available in the zones. Our group already has suggested many such measures, ranging from priority in receiving federal discretionary funds, to federal contract preference, to waivers of banking regulations that constrain lending and investment in poor areas. The attached addendum details a preliminary list of possible benefits whose effects could far outstrip those of the tax incentives currently proposed for the empowerment zones.

The track record of the states' zones tells that offering benefits of this nature by itself would do far more to boost the effect of the zones than many would predict. Surveys of our own members indicate that the very prospect of inclusion in such a national policy will motivate cities and states to work more closely together to revive distressed areas.

We have projected that greatest overall impact will be made on this lower tier of zones, but we also favor offering deeper incentives on an experimental basis to a limited number of competitively designated areas. The empowerment zone proposal would provide for such an upper tier of participants that would qualify for a number of incentives, including tax credits for hiring zone residents, an enhanced investment expensing benefit and accelerated depreciation of property.

The dilemma that both the administration and Congress face in implementing such a system is a matter of determining how to conduct a limited experiment with tax incentives. If the program offers very generous incentives in just a handful of areas, it runs the risk of merely demonstrating something we cannot afford to replicate. If benefits are spread too widely, the effects will be too diluted to yield useful data.

Rather than indicate a specific, ideal number of upper-tier zones, we would simply suggest Congress and the administration appreciate the difference between demonstration and experimentation. When we first recommended this multi-layered system, we foresaw a need to conduct controlled experiments with various benefits. Understanding better how any given incentive works in relation to the zones' overall objectives may be instructive in tailoring future incentives. For example, we would hope that zone benefits eventually can be geared to individual local priorities,

such as trade development, retail area revitalization, rural economic diversification and military base conversion.

Finally, we would encourage this committee, Congress and' the administration to regard the new empowerment zone proposal as the beginning of a process rather than a culmination. We as a country have been without a policy on our economically distressed areas for more than a decade.

We have much to do and much to learn. But if we can break the gridlock iii this field of policy making and begin forging a new relationship among the cities, states and federal government, we will have taken an important step in the right direction.

ADDENDUM

Every empowerment zone-eligible area should have access to federal benefits that have little or no net budgetary impact. Following are a few ideas of advantages that could be offered to all of these localities.

- *Coordinate the Community Development Banks concept with the zones*—As the administration introduces its proposal to replicate the experience of Chicago's Shorebank, it should link the concept with zone-eligible areas. Having ready access to such institutions might help encourage small-scale entrepreneurship in the targeted areas.
- *Special rules for financial institutions*—Banks, savings and loans and other financial institutions should be offered relief from regulations that restrict their ability to make more capital available for development in low-income areas. A few examples might include the following:
    - *Savings and loans* must make 65 percent of their loans in the housing sector. By offering them the flexibility of making perhaps 5 to 10 percent of their loans to commercial or other activities in zone-eligible areas, we might free up more capital for entrepreneurs in these neighborhoods.
    - *Banks* have been severely hampered in making commercial real estate loans by prohibitively high risk-based capital requirements. Any portion of a bank's loan portfolio going to zone-based commercial borrowers should have no higher capital requirement than the rate for home loans.
    - *Credit unions* serve many areas that have been underserved by banks and yet they are prevented by regulation from making business loans in amounts greater than $75,000. The upper limit on the loans should be no less than the credit union limit on loans to members. This is equal to 10 percent of unimpaired capital and surplus.
- *Require corporate beneficiaries to contribute to the funding of local zone support organizations.* Indiana's Urban Enterprise Associations (UEAs), made up of representative, of the neighborhood, of local businesses and of the municipal government, have been at least as responsible for the success of the program as the tax incentives. They are supported by contributions equaling 15 percent of the benefits realized by zone-based companies.

These revenues fund not only the administrative staffs of the zones but tangible improvements and services needed by zone residents. Day care centers, mini-van services, housing upgrades and infrastructure repairs in the zones have been common UEA projects. In effect, this feature expands the scope of the program from a mere local tax inducement scheme to a thoroughgoing, public-private partnership in community development.

A similar measure drawing from the $4 billion in tax benefits that are included in the administration's zone initiative could yield a pool of several hundred million dollars in direct funding. These resources should be used for improvements that designated neighborhoods need far more than the participating companies need tax relief. The experience of Indiana already has demonstrated that such a program feature actually works and is well accepted by residents and the business community alike.

A portion of these contributions also could be used to support evaluation research and other information development activities needed to support the overall zone policy. By self-financing such functions in this way, we would actually reduce the program's cost.

- *Redevelopment bonds*—Section 144(c) of the Tax Code permits municipalities to issue tax-exempt bonds to support the clearance of urban sites and installation of infrastructure needed to accommodate new business. However, because of the number and complexity of regulations governing this development tool, it almost never has been used. (In the rare cases where it has been applied, some projects

have gone into default.) A waiver of some of these restrictions could make the bonds more usable in zones.

• *Small-issue industrial development bonds (IDBs)*—States nominating areas for federal enterprise zone eligibility should be required to set aside 5 percent of their annual volume cap for private activity bonds for use in zones.

• *Targeting of all measures listed in the Catalogue of Federal Domestic Assistance*—The federal budget is replete with grant programs for a wide range of research, demonstrations, education, training and development initiatives. The federal government should conduct an analysis of the Catalogue to determine which grants could be awarded on a priority basis to applicants operating in zones or awarded to entities (charitable, educational, civic organizations) whose missions relate to an enterprise zone's course of action.

• *Bidding advantage for federal procurement contractors*—Any firm located in an eligible area should qualify automatically for preference in bidding for new federal procurement contracts.

• *Federal coordinating councils*—Section 303 of a 1991 enterprise zone bill (HR 23) stated:

> "In order to maximize all agencies' support of enterprise zones, the Secretary of Housing and Urban Development is authorized to convene regional and local coordinating councils of any appropriate agencies to assist State and local governments to achieve the objectives agreed to in the course of action under section 7880 of the Internal Revenue Code of 1986."

This relatively obscure provision could have a significant effect on the way the federal government implements the policy. It suggests a high level of cooperation among federal agencies with a role in economic development. This approach should be strengthened and incorporated into the federal implementation plan for zones.

• *Abandoned Land Reuse Act*—This new initiative would provide federal support for the decontamination of properties with the potential both to stimulate reinvestment in urban areas and to alleviate pressure to develop current "greenfield" sites. Such a program might become operational sooner that it would otherwise if it were implemented first on a limited basis in zones.

• *Encourage private participation in the course of action*—The policy should embrace private sector- and foundation-supported inner city redevelopment projects, such as Jimmy Carter's work in Atlanta or the Enterprise Foundation's Sandtown project in Baltimore. To date most of these activities have been viewed as something distinct from enterprise zone operations. The federal policy should make it clear that these projects will be welcome contributions to the applicant's overall course of action.

• *Organize teams of students benefiting from federal college loans to work in zones*—the zones would represent logical project sites for students who agree to retire their college loans through community service. They could provide assistance in areas ranging from youth mentoring, to housing rehabilitation, to technical expertise in establishing credit unions, to graffiti removal, to block watches.

Senator LIEBERMAN. Thank you, Dick. I appreciate your statement.

Let me ask you a question similar to the one I asked before of the representatives of the administration. Could you make any estimate at this point of how many eligible areas might exist Nationwide, how many areas are eligible for enterprise zones?

Mr. COWDEN. I wish we had a map. We wish we could sit down with Census and do an overlay and see exactly, given the criteria that they have, how many areas would be eligible.

We have envisioned a program that would have, perhaps, 500 or so eligible areas. Just to give you a perspective, if we were trying to plug in to what the States have already come up with, we are estimating there are about 800 areas, but if you control for the States of Arkansas, Louisiana, Kansas and Ohio, all of which have gone over 100 zones, there is an average of about 25 zones per State, and we think that is not too bad of a benchmark.

Senator LIEBERMAN. Very good. That is helpful.

Mr. Paul Pryde of Pryde & Company. Thank you very much. Welcome.

STATEMENT OF PAUL PRYDE, PRYDE & COMPANY

Mr. PRYDE. It is a pleasure to be here, Senator Lieberman. I, like Dick, hope that we are luckier than we have been in the past in passing enterprise zone legislation, although I do have some problems with the administration's bill which I would like to address.

Before I go farther, I would like to applaud both the generosity and the ambition of the administration's bill. We are talking more than $8 billion in tax incentives and direct Federal spending to designated zones, and it would also establish a Cabinet-level mechanism to deal with regulatory policy barriers to the effective functioning of the zones.

Yet despite its intent, the proposal has two flaws that I believe will produce somewhat disappointing results. First, the administration's proposal appears to be based largely on the idea that problems of poor communities result from a scarcity of Government resources. As a result, it relies heavily on Federal grants and coordination as the means to encourage development activity within designated empowerment zones and enterprise communities.

While improving the way Government works is certainly a part of the strategy for revitalizing poor communities, improving the way labor and capital markets work in these communities is even more vital.

It is no doubt true, as the administration asserts, that tax breaks alone are incapable of solving all of the problems these communities face. I do not think any of us would disagree with that assertion.

However, we all know that a well-designed tax policy can play a powerful role in making market forces work for rather than against places which need new jobs, new businesses, and new housing. I might add parenthetically that anyone who doubts the power of the tax policy to shape private behavior has certainly not been looking at the debate over the recent energy taxes.

This brings me to the second and related flaw in the administration's plan—its tax incentives. Almost everyone agrees, and we have had about 11 or 12 years of testimony on enterprise zones, that in order to create jobs and economic activity in poor areas, enterprise zones must become incubators of new and expanding firms. The alternative, trying to attract facilities of big business, will prove both costly and ineffective.

I saw some data yesterday that suggested over the last 10 or 11 years, the Fortune 500 companies have eliminated 4 million jobs, and they are not likely to create any new jobs even if they were willing to locate in enterprise zones.

Almost all small business experts agree that the scarcity of capital, especially risk capital, is one of the principal barriers to increased business formation and growth in poor areas. We also know that in their early years, young job-creating firms typically have very little tax liability. They show no profits. Even the most successful firms generally show significant operating losses which all but eliminate early corporate income tax liability.

Accordingly, enterprise zone capital provisions should have been designed to make zone firms more attractive to investors. In other words, the idea should not be to reduce the tax of zoned firms, but to enact investor-level incentives which would encourage investors to make investments in zone firms. By increasing the supply of financing available to zone businesses, investor-level incentives would spur more rapid business growth and the creation of more jobs for zone residents.

Unfortunately, at least two of the provisions in the administration's bill, simply liberalize the rules for depreciating and expensing investments in property. In other words, the bill's incentives would be most useful to firms most likely to provide jobs within the zone and least useful to those most likely to create employment.

Senator LIEBERMAN. Could you say those last few sentences again?

Mr. PRYDE. In other words, most of the firms that we really want to locate and grow in the zones are not going to have tax liability. They need capital. The firms that are least likely to locate in the zones do have tax liability. Unfortunately, the administration's incentives go to firms which have tax liability and not to the firms which do not, those which are most likely to be in zones.

What they really need to do is target incentives to investors to compensate them for the added risk of investing in zone firms and in poor communities, and I think if you look, back over 11 years of testimony, you will see there is a clear consensus that is a need.

As I remember, having testified back in 1981 or 1982, that we then considered accelerated depreciation and similar tax reductions, and they were discarded over time, driven out of the debate in large part by the evidence presented by David Burch and others, who suggested such incentives would not be useful to job-creating small firms, the only type likely to really be successful in enterprise zones in creating employment.

I would suggest that the section 179 expensing and accelerated depreciation provisions should probably be replaced by at least one of two other measures that I think would be far more useful to zone firms and ultimately to zone residents. The first is the equity expensing incentive included in most previous enterprise zone proposals. This provision would permit individual taxpayers that purchase stock in eligible zone firms to deduct the cost on their tax returns.

Under H.R. 11, the House bill that was enacted and passed last year, the amount of the deduction was limited to $25,000 in one year and $250,000 in total. One may argue with the limitations. Some would like higher limitations—I certainly would, a higher ceiling—but certainly the principle of the idea is a good one, in my judgment.

The effect of this provision, as I said, would be to increase the willingness of investors to finance zone firms by compensating them for the added risk and cost that they would encounter.

I would like to talk about what the numbers look like. If you assume a 30 percent highest marginal tax rate, an ordinary investment that doubled in value after 5 years would produce an after-tax return of about 10.5 percent. However, equity expensing would

increase the after-tax return on the same investment to 20.7 percent.

In other words, it would double it. That is enough, in my judgment, to make a difference in investors' decisions to essentially create a level playing field to make investors neutral as between zone investments and nonzone investments.

A second, perhaps equally useful provision would be to allow investors to defer capital gains on the sale of any asset where the proceeds of the sale are invested in zoned firms. The incentive would encourage taxpayers who already are invested in the zone to reinvest there, and would unlock money now tied up in other assets for investment within the zone. Once again, the effect of the provision would be to increase zone investment by offsetting added risks and costs.

To increase the incentive's benefits to zone residents and workers, capital gains deferral in connection with the sale of zone assets might be made available only where the asset is sold to an employee stock ownership trust or other similar vehicle for broadened ownership.

I want to mention before I close two ancillary benefits, I think, from these incentives. The first is that these incentives are likely to produce strength in the new financial intermediaries in the inner city.

As we all know, financial intermediation is key to getting credit and capital from investors and savers, to borrowers and investees, and it is very likely that most people who are tax-driven to invest in a zone will not want to make the investments themselves. They will be very much susceptible to arguments that they ought to pool capital and have their capital managed by small business investment companies, specialized small business investment companies and the like. That would strengthen those organizations and create a much-needed institution in the inner city.

A second point is that the availability of risk capital, equity capital, would make credit more available, and we all know that as of August of this year the Community Reinvestment Act is going to require banks to catalog what they are doing with respect to small business loans, and they are going to have difficulty making an increased number of small business loans that do not expose them to significant risk.

If we had these incentives, we could increase the equity that is the borrowing base of small business in the zone. You would also have the effect of making credit more available, and so those are two ancillary benefits which I do not think can be ignored.

Thank you.

[The prepared statement of Mr. Pryde follows:]

Prepared Statement Paul L. Pryde

Good morning, Senator Lieberman. My name is Paul Pryde. I am President of Pryde and Company, a consulting firm specializing in economic development policy and finance. I am also an Adjunct Fellow of The Empowerment Network Foundation and a director of the Corporation for Enterprise development, two policy groups organized to develop entrepreneurial solutions to the problems of poverty and unemployment. Having been involved in the enterprise zone debate for more than 10 years, I am happy to appear before you to express my views on the Economic Empowerment Act of 1993, the Clinton Administration's enterprise zone proposal.

Let me say before anything else that I applaud both the generosity and ambition of the Administration's bill. H.R. 2141 would not only target more than $8 billion in tax incentives and direct federal spending to designated zones, but would also establish a Cabinet-level mechanism to deal with regulatory and policy barriers to the effective functioning of the zones. As a proposal to marshal public resources against the problems of poor inner-city and rural economies, it is an impressive plan indeed. Yet, despite its intent, the Administration's proposal has two flaws that I believe will produce somewhat disappointing results.

First, the Administration's proposal appears based on the idea that the problems of poor communities result from a scarcity of government resources. As a result, it relies heavily on federal grants and coordination as the means to encourage development activity within designated Empowerment Zones and enterprise communities.

While improving the way government works can be part of a strategy for revitalizing poor communities, improving the way labor and capital markets work in these communities is even more vital. It is no doubt true, as the Administration claims, that tax breaks alone are incapable of solving all of the problems that these communities face. However, it is even more true that taxes can play a powerful role in making market forces work for, rather than against, places that need new jobs, new businesses and new housing. Even small changes in tax policy can make major differences in the location of investment, employment and entrepreneurial activity. I might add, parenthetically, that anyone who doubts the power of tax policy to shape private behavior has obviously not being paying attention to the recent debate over energy taxes.

This brings me to the second, and related, flaw in the Administration plan, its tax incentives. Almost everyone agrees that in order to create jobs and economic opportunity in poor areas, enterprise zones must become incubators of new and expanding firms. The alternative, trying to attract facilities of big business has proven both costly and ineffective. Most reports show that America's largest companies are eliminating, not creating jobs and that tax breaks are generally powerless to affect their location decisions.

Almost all small business experts agree the scarcity of capital, especially risk capital, is one of the principal barriers to increased business formation and growth of in poor areas. We also know that in their early years, young, job-creating firms will typically have very little tax liability. Even among the most successful firms, early start-up and operating losses will often eliminate corporate income tax liability for years to come.

Accordingly, enterprise zone capital provisions should have been designed to make zone firms more attractive to investors. By increasing the supply of financing available to zone businesses, such an incentive would spur more rapid business growth and the creation of more jobs for zone residents.

Unfortunately, the Administration's bill simply liberalizes the rules for depreciating and expensing investments in equipment. These incentives would reduce the tax bills of zone firms that happen to purchase equipment. They would do little to increase the availability of capital to any zone firm, especially those that have no tax liability. In other words, the bill's incentives would be most useful to firms least likely to provide jobs within the zone and least useful to those most likely to create employment.

To correct this flaw, I would suggest that the Section 179 expensing and accelerated depreciation provisions of the Administration be eliminated from the bill and replaced by one or both of two other measures that would be far more useful to zone firms, and ultimately, to zone residents.

The first is the "equity expensing" incentive included in most previous enterprise zone proposals. This provision would permit individual taxpayers that purchase stock in eligible zone firms to deduct the cost on their tax returns. Under most proposals, the amount of the deduction was limited to $25,000 in any one year and $250,000 in total. The effect of this provision would be increase the willingness of investors to finance zone firms by compensating them for the added risk and cost of investing in unproven firms in less prosperous communities. That is to say, for an investor in the proposed 36 percent tax bracket an investment that doubled in value after five years would ordinarily produce an after-tax return of 10.4 percent. However, equity expensing would increase the after-tax return on the same investment to 20.7 percent.

A second, perhaps equally useful provision, would be to allow investors to defer capital gains taxes on the sale of any asset where the proceeds of the sale are invested in zone firms.

This incentive would encourage taxpayers who have already invested in the zone to reinvest there and would "unlock" money now tied up in other assets for invest-

ment within zones. Once again, the effect of the provision would be increase zone investment by offsetting added risk and cost with significantly increased return.

To increase the incentive's benefit to zone residents and workers, capital gains deferral in connection with the sale of zone assets should only be available where the asset is sold to an Employee Stock Ownership Trust or similar vehicle for broadened ownership.

President Clinton has repeatedly expressed his strong desire to use market forces rather than expanded government as the engine of economic development and empowerment in poor communities. I believe that changes I have recommended will help ensure that the Administration's Empowerment Zone proposal helps fulfill that commitment.

Senator LIEBERMAN. Thank you, Mr. Pryde. That was excellent testimony, and you have some great ideas. I wish you were on the Finance Committee, too.

I am afraid I am going to have to close the hearing at this point. I appreciate not only your patience in waiting until the end—it has been a very interesting morning, and I must say, all of it, including the testimony of the three of you, reinforces some of the feelings that I had about the proposal and makes me want to find allies along the way to see if we cannot make this turn out right.

I think there is a presumption around here that because of the support in the House for the enterprise zones that this is going to be part of a final package, but you never know, and the important thing is that it come out right, so you have given me some good ideas to help make that so.

We are going to keep the record of the hearing open for 2 more weeks, if anyone wants to submit additional testimony. I thank you all very much for participating, and this will formally adjourn the hearing.

[Whereupon, at 12:55 p.m., the Committee adjourned.]

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